SURETY BOND GUARANTEE PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON SBA AND SBIC AUTHORITY, MINORITY ENTERPRISE AND GENERAL SMALL BUSINESS PROBLEMS

OF THE

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SURETY BOND GUARANTEE PROGRAM

TUESDAY, MAY 17, 1983

House of Representatives, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, Committee on Small Business,

Washington, D.C.

The subcommittee met, pursuant to notice, at 9:33 a.m., in room 2359-B, Rayburn House Office Building, Hon. Parren J. Mitchell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN MITCHELL

Mr. Mitchell. Good morning. Today we begin a hearing on the Surety Bond Guarantee Program administered by the Small Business Administration.

The Surety Bond Guarantee Program was established under title IV of the Small Business Investment Act of 1958. The primary purpose of the program was to entitle SBA to extend a guarantee against loss to a surety in order to make bonding available to public and private small business contractors if a bond is not obtainable under reasonable terms and conditions by private sureties. All general and special trade contractors such as the electrical, plumbing, heating, et cetera, and service contractors whose gross annual receipts do not exceed $3,500,000 are eligible for program participation.

It is of critical importance that minority contractors understand the underwriting requirements of sureties when applying for a bond. There are presently over 39,000 minority contractors in this country, none of whom can afford to ignore the importance of bonding as it relates to increased prime and subcontracting opportunities. At the same time, sureties and the Small Business Administration must be acutely aware of the bonding problems encountered by minority contractors in an effort to increase bonding availability to these firms.

With regard to bonding authority, the present continuing resolution sets a program level of $1.2 billion for fiscal year 1983. In its policy views to the House Budget Committee concerning the Small Business Administration's 1984 budget, this committee recommends $1.6 billion in surety bond guarantees. This would be $400 million above the amount contained in the continuing resolution. This recommendation recognizes that the program will be particularly important to small minority contractors who need such bonds in order to be eligible to bid on the construction set-aside of $7 billion in last year's Surface Transportation Assistance Act, which is Public Law 97-424.

This committee is concerned with how to increase standard surety participation in the SBG program, and with improved coordination of efforts with specialty sureties. We would like to encourage the establishment of liaisons by the Small Business Administration with State insurance commissioners to expedite an effective operation of the SBG program.

In conclusion, today's hearing is prompted by the indisputable fact that minority construction firms, particularly, continue to be effectively prevented from obtaining larger projects which are so vital to market expansion. Inability to obtain bonding remains a hindrance to growth. Inability of minority construction firms who may have defaulted on contracts to obtain financial assistance stops growth altogether.

It appears that we have come to the point where some difficult decisions will have to be made about SBA's priorities for the future operation of the surety bond program. It constitutes an exercise in futility for Congress to legislate construction set-aside programs for minority contractors when these very same contractors cannot obtain bonding assistance from either private sureties or the Federal Government. We must decide what programs and services are essential to small business, and realign existing resources to conform to these decisions. Such decisions may well involve legislative action. Where appropriate, SBA should consider delegating to or contracting with the private sector to expand its involvement in areas designed to aid small businesses, especially bonding. Undoubtedly, any effort to consolidate and realign will require some innovative and creative approaches to getting the job done well.

Our witnesses today include minority business trade organizations, minority contractors, business experts, and representatives from various Government agencies and departments. I am confident that the testimony that we will receive today will be invaluable to this committee as well as to the Small Business Administration during their deliberations on the Small Business Administration's Surety Bond Guarantee Program.

I want to thank all of our witnesses for taking the time to be with us this morning. I thank all of those who got their testimony in early to us.

Unless there is some objection, I would like to try to hear the witnesses in panels of three. If any witness is not satisfied with that, that will be all right.

The first is Mr. Arthur Meushaw, American Subcontractors Association. Yes, sir, thank you for being here. Mr. Dewey Thomas, Jr., the executive director of the National Association of Minority Contractors. Third, Dr. John F. Magnotti, Jr., the executive vice president of The American Specialty Surety Council.

Gentleman, I thank all three of you for being here. I am sorry that we had to use the smaller hearing room. There are three subcommittees of the Small Business Committee conducting hearings simultaneously, and we were generous and took the small room for ourselves.

The only problem that you might encounter is with your mikes. There are only two, and they fit right into a recorder. So when it comes your turn to testify, shift the mike so that you can talk directly into it.

In addition, we have copies of all three of your testimonies. If you so desire, we can simply submit the entire testimony for the record, and you can give the high points. If you desire to read your whole testimony, fine.

Do you have a preference? We can submit the entire testimony for the record.

Mr. **THOMAS**. I would like to do a combination of both.

Mr. **MITCHELL**. A combination of both?

Mr. **THOMAS**. Yes.

Mr. **MITCHELL**. A combination of both, that is fine.

All right, Mr. Meushaw, would you lead off for us, please, and pull your mike right up to you.

TESTIMONY OF ARTHUR MEUSHAW, PRESIDENT-ELECT, AMERICAN SUBCONTRACTORS ASSOCIATION

Mr. **MEUSHAW**. My name is Arthur Meushaw, and I am a local subcontractor, and president of Standard Acoustics, Inc., in Washington, D.C. I have been in the position that I currently hold for over 30 years, as you can see by my gray hair. That should not be in the record.

Mr. **MITCHELL**. It is too late now, Mr. Meushaw.

Mr. **MEUSHAW**. I am also president-elect of the American Subcontractors Association. And I want to thank you, Chairman Mitchell, for asking us down here.

Today I am speaking on behalf of ASA, which represents about 5,000 construction firms throughout the country. The subject of bonding is a subject which is dear to all construction people's hearts.

Our association has recently put out this bonding pamphlet. I think that it is rather well done. At least, it took several years in getting together with the National Association of Surety Bond Producers as well as our outfit to put it out.

As the manual will show, and I believe that my statement also shows, that along about the middle of the seventies, there were major problems throughout the United States in bonding for everybody. The major companies which are mostly insurance companies were experiencing a tremendous squeeze on profits. They were losing money, or at least they claimed that they were losing money.

Outfits like mine which went into business in 1934 had been bonded by your major people. They came to us. At that time, we could not have had a stronger financial position, at least relative to all of the other years. That became a time when I had to personally indemnify.

So that is the personal background of myself and my company, and the influence of bonds in our business. It has been said that bonding instead of going out of the picture is going to get more important. There are going to be more problems.

Whether that is true, Mr. Mitchell, I really do not know. But you might say that is what we are being told.

Today, bonds are required in the private sector—I will just hit a couple of highlights of your paper. I notice that there will be persons speaking this morning from the industry, who will be a lot more cognizant than I am of the technical sides of bonds. There are basically bid bonds, performance bonds, and payment bonds. I do not propose to get into the SBA side of the situation, nor do I want to go into the definition of a surety. I believe that this committee knows what that is.

I would like to point out something, though, that through the years has been stressed; namely, a surety is more akin to banking than insurance. A lot of us small subcontractors think that for some reason that a surety and a bond is insurance. It is really a line of credit. When a banker grants a loan, and this is where I think that we are having problems at the SBA level, too, when a banker grants a loan, he fully expects to have the loan repaid. And he investigates in respect to the borrower in sufficient detail to be sure that this will be the case.

With respect to getting a bond, there are three basic—and I am talking from a street level, if I may—there are three basic "C's." You need a bond, and you go into business. You should have knowledgeable persons, like people in my outfit that have been around for a long time. You can come to us, you can come to our association.

Incidentally, the Washington, D.C., Subcontractors Association is probably the strongest in the country. It ranks No. 2 in numbers of people. There are almost 400 firms. It is open to everybody, and we solicit all people regardless of race, or whatever.

The three "C's" are first, the contractor's ability to do the work. We all know that that is a problem. We had a problem on the Washington Metro. When we first started out on Metro, and to meet certain requirements, there were some failures. And, of course, this will happen at any time that you are maybe starting up a program.

But in any event, you have to know what you are doing, let us say. My paper goes into the fact that you need education and professional training. The bonding company will look at the track record of the firm. They will take a look at trade references, provisions for continuation of the firm. We all know about key-man insurance. The firm's long-term plans, and so on.

The second "C" is capital. Well, we would not be here if everybody had capital. I guess that we would not need bonds, you know, going back 100 years ago. So it takes money to start up in the financial retainage.

The third "C," of course, is character. And I somtimes wondered when we suffered through the middle seventies when I did not want to indemnify personally, whether the word character means anything. Frankly, at that time, I do not think that it meant a lot. I think that they wanted to see some hard evidence.

So, hopefully, with those three "C's" put together, a person can get a bond. And as I conclude, the SBA's Surety Bond Guarantee Program was designed to help the person who has character, and experience, but no money. Hopefully, it has done that.

I know from a personal standpoint, that the legislative intent was to create bonding assistance for all businesses, not just minorities.

I have two sons who are struggling to get going, and then go on their own. Like a bird out of the nest, and then they fly. Whether that is happening to other young entrepreneurs is going to be very interesting to learn today.

Thank you, for your attention. And it is a pleasure to talk to you again, sir.

[Mr. Meushaw's prepared statement follows:]

Prepared Statement of Arthur C. Meushaw, President-Elect, American Subcontractors Association

My name is Arthur C. Meushaw. I am president of Standard Acoustics in Washington, D.C. I am also president-elect of the American Subcontractors Association (ASA).

Today, I am speaking on behalf of ASA, which represents nearly 5,000 construction firms in 49 chapters around the country. ASA is the only national trade association that solely represents the concerns and interests of all construction subcontractors, regardless of trade specialty. According to the latest government census, subcontractors perform over 80 percent of the commercial/industrial construction in the United States. ASA's primary mission is to improve business conditions for its members through education and cooperative action.

Although surety bonds have been issued in the United States for approximately 100 years, there is often a great deal of confusion about the hows, whys, and wherefores of contract bonding. Thus, Chairman Mitchell has invited me to testify before this subcommittee today to explain the importance of surety bonds to construction contractors, the concept of surety bonds, and how a contractor obtains a bond. To help with this task, I have provided each member of the subcommittee with a book entitled Bonding for Subcontractors which was recently published by ASA.

THE IMPORTANCE OF BONDS

The relationship between the construction industry and bonding companies is almost a century old, although the existence of sureties has been with humankind since the invention of commerce. One of the most popular dramas in English literature—The Merchant of Venice—deals with the peculiarities, eccentricities, and even the dangers of suretyship. However, if everyone had listened to the advice of Shakespeare when he said, "Grant I may never prove so fond, to trust man on his oath or bond," the construction industry as we know it would not exist.

Today, bonds are required in the private sector as well as by federal, state, and local governments. And the use of bonds is growing rapidly as more and more general contractors require subcontractors to demonstrate "equal security" for the subcontractor's part of the work. ASA has estimated that subcontractor bonding will double—and perhaps even triple—during the next five years. So, if as Cervantes has Don Quixote say, "an honest man's word is as good as his bond," a contractor's word carries the value of a plugged nickel unless it is accompanied by some acceptable surety company's product. Thus, bondability is vital to any construction contractor wishing to move beyond very small projects.

Though there are many different types, there are generally three basic contract bonds common in the construction industry: bid bonds, performance bonds, and payment bonds.

It is the bid bond which serves as the basic "prequalifier" on most projects. To obtain a bid bond, a contractor must prove to a surety company that his firm has the ability to enter into a contract if one is offered and that he can qualify for whatever additional contract bonds may be necessary to fulfill the contract terms.

A performance bond warrants that the contractor will build that which he has contracted and will build it according to the contract's plans and specifications.

The payment bond assures subcontractors and suppliers are paid, subject to any limitations spelled out by contract or by law.

Since these instruments are required before a contractor is eligible to bid on most major projects, bondability becomes a question of survival for most contractors. For construction firms, bond capacity is a literal life or death matter.

WHAT IS SURETY?

Because most surety bonds are issued by insurance companies and regulated by state insurance commissioners, they are often thought to be insurance. This most assuredly is not the case. There are some basic characteristics of corporate suretyship which distinguish it from insurance:

Unlike the two-party insurance agreement, the surety agreement is a three party contract, between the surety, the principal, and the obligee.

The surety bond is based upon an underlying contract which must be in writing.

In surety losses are not expected, as is the case in insurance, and premiums are not computed on the probability of loss. Insurance premiums are determined by actuarial methods. Surety is not subject to these methods, and the fee charged for a surety bond, also called premium, is meant to pay the expenses of the surety company in underwriting the bond.

The surety has special legal rights—and obligations. One of these called "subrogation" means that if the obligee turns to the surety for satisfaction under the bond, and if the surety, taking the place of the principal in fulfillment of the surety contract, suffers a loss or expense, the surety has all the rights of the obligee under the underlying contract. "Indemnity" is the surety's right to be reimbursed by the principal for any such loss or expense.

Performance or payment bonds are usually not cancellable—unlike an insurance policy.

If a parallel must be found, surety is more akin to banking than to insurance. Bankers, as you well know, extend credit either as actual money loaned or as a commitment to loan money, called a "line of credit." When a banker grants a loan, he fully expects to have the loan repaid, and he investigates the prospective borrower in sufficient detail to assure that this will be the case. A surety underwriter does the same thing—he thoroughly investigates the prospective principal to assure himself that he has the wherewithal to satisfactorily perform the obligation being bonded. No self-respecting surety underwriter ever expects the bond to be called upon. Of course, since human judgments are fallible and external factors occur over which there is little control, both sureties and bankers often suffer losses.

GETTING A BOND—THE THREE "C'S"

As I have discussed, a surety is concerned with guaranteeing a contractor's performance and the payment of bills. The surety will want, then, all of the information it can get about what in the industry is called the three "C's"—capacity, capital, and character.

The first "C" is capacity—the contractor's ability to do the work. The surety wants to be sure that the contractor has the ability to manage as well as construct. To determine if a contractor can handle the project, the surety will delve deeply into a myriad of internal functions, including:

The educational, professional, and contracting background of key people in the firm;

The track record of the firm;

Trade references, including project owners, general contractors, subcontractors, and suppliers with whom the firm has done business;

Provisions of continuation of the firm in the event of the incapacity or death of key people in the firm;

The firm's long-term plans; and

The contractor's rationale for wanting to do the project, especially in the case of a project larger than anything done before.

The second "C" is capital. It takes money to start up a job, to finance retainage, to pay the overhead, to prepay bills and take the resulting discounts, to finance slow receivables, and to insure the availability to bank credit. The amount of money needed can depend on the type of work being performed or the organization performing it.

The surety's purpose in analyzing a company's financial standing is two-fold:

To make the judgment about the firm's financial healthiness; and

To judge whether the firm's assets are adequate to cover the surety against any losses that may arise during construction.

Among the factors a surety will examine to determine a company's financial strength are: credit references; bank credit; cost records; and financial statements, including a balance sheet and a profit and loss statement.

The third "C" is character. The surety will almost always ask the contractor to provide the personal indemnity of the stockholders of his company and probably that of their sponsors as well. Those who indemnify will almost certainly be asked to provide personal financial statements to show what that indemnity is worth.

This is sometimes a sensitive area. But simply because a surety has issued a bond does not mean it expects to be saddled with the contractor's obligations. If the contractor fails to perform or pay his bills, the surety expects him to do what any honorable businessman would do if there were no surety involved: complete the contractual obligation using whatever means at his disposal. The willingness of the contractor to stand behind his company and support it with his personal assets is a very important consideration of a surety. In a sense, he is being asked to put his money where his mouth is.

SBA'S SURETY BOND GUARANTEE PROGRAM

It is not unusual for even an experienced small contractor to have some difficulty in obtaining surety credit. Most sureties have concluded that small contractors are qualitatively a riskier proposition and also that they are expensive to handle. As a result, some sureties have set minimum experience requirements or minimum years in business requirements. Others have set minimum financial limits involving minimum net worth or working capital. The underlying rationale for these minimum financial requirements appear to be that the lack of a financial cushion leaves a contractor unable to sustain himself in the event of an impairment of his cash flow, a significant loss on a job, or a long period without work where existing capital is consumed by overhead.

In 1968, the U.S. Small Business Administration was granted the authority to issue guarantees to surety companies whereby the SBA would reimburse a surety for losses up to 90 percent of any bond written up to certain stated limits. For the program, a small business is defined as one having an average annual sales volume of $3.5 million or less over the last three years. Contractors with projects of $1 million or less are eligible for the SBA bond guarantee program, and there is no limit to the number of bonds that can be guaranteed to any one contractor. The program is primarily designed to help the contractor who cannot meet the minimum experience requirements, the minimum years in business requirements, or the minimum net worth or working capital requirements. The surety bond guarantee program has provided guarantees on billions of dollars of construction bonds thus enabling the sureties to accept riskier proposals without being overly concerned about losses which they might not accept if they had to absorb them by themselves.

To enter the SBA program, the contractor must go to his surety bond underwriter and begin the complex review process I described earlier. The underwriter performs his check and sends a summary of the information to SBA. The SBA staff reviews the information and decides whether or not to guarantee the bond requested.

CONCLUSION

Mr. Chairman, I thank you and the members of this subcommittee for inviting me to testify before you today. I hope the background and technical information I have provided will help you in your review and analysis of SBA's Surety Bond Guarantee Program.

And, of course, I would be pleased to answer any questions you may have.

Mr. MITCHELL. Thank you. I have questions. I think that I will just hold them until we hear from all three of the panelists.

Mr. Magnotti, do you want to go next?

Mr. MAGNOTTI. Yes, sir.

TESTIMONY OF DR. JOHN F. MAGNOTTI, JR., EXECUTIVE VICE PRESIDENT, AMERICAN SPECIALTY SURETY COUNCIL

Mr. MAGNOTTI. Mr. Chairman, my name is John Magnotti, and I am the executive vice president of The American Specialty Surety Council. We are here today to make a joint statement with the National Association of Minority Contractors whose executive director, Mr. Dewey Thomas, is here at the table with us.

Our statement will be relatively short. I will begin by presenting the issues as we see them. Mr. Thomas will then outline the problems associated with the program, as it is currently being administered. We will conclude by jointly offering two major recommendations, and we hope that this is an up statement, which we believe will provide positive assistance to small contractors in obtaining bond guarantees under the Surety Bond Guarantee Program.

We will then be pleased to answer any questions that you and the other committee members might have concerning the problem areas in the program or our recommendations.

Since both our organizations appeared before this subcommittee on April 27 of this year to testify on H.R. 860 and H.R. 2132, we will not repeat the information that we presented at that time on the scope of the membership of our organization.

We feel that there are two basic issues in connection with the SBA Surety Bond Guarantee Program. The first issue is the need to increase the utilization of the program by all small contractors who are unable to obtain bonding in a standard market, and in the process to fully utilize the SBA guarantee authority.

The second issue is to develop a better understanding of the program both within the government, and among those small businessmen who are potential recipients, and equally as important among the agents and sureties who execute the program in partnership with the Federal Government.

Both of these issues were discussed at length in our previous testimony, so I will not repeat that entire discussion in the interests of time. However, briefly, last year, there has been an almost disastrous decline in the utilization of guarantee authority in the Surety Bond Guarantee Program. We talked about that before.

Many reasons contributed to this decline both within the Government, and as the result of a general economic decline suffered by small businesses. Because of the restrictions of the Miller Act, it appears virtually certain that when you combine this with the Surface Transportation Assistance Act, and that is $7 billion, that the demand for bonds is going to increase dramatically over the next year or so, or a couple of years.

As a matter of fact, we anticipate that this demand might go well beyond the guarantee authority levels contained in H.R. 2132, which are $1.6 billion. It might even go beyond that.

This increased demand then creates the basis for our second major issue, and that is the dissemination of information about the program to the small business community, most particularly by firms owned and controlled by socially and economically disadvantaged individuals.

A corollary to this issue of the dissemination to the small business community is the dissemination of information about the program among Government officials to insure maximum utilization of the program wherever possible in all Government construction programs.

I will now defer to Mr. Thomas to continue with our statement.

TESTIMONY OF DEWEY THOMAS, JR., EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF MINORITY CONTRACTORS

Mr. THOMAS. Mr. Chairman, first, I would like to say that our association is in full support of the bond guarantee program, and that most of our members who are members of our association need this program badly. And when we see the under-utilization of it, that throws up a red flag to us. There are too many contractors out here, and now with the passage of the Surface Transportation Act, section 105(f), there is going to be a tremendous demand and need for bonds; and because of the Miller Act requirement, we are going to have to be able to obtain bonding in some way, shape, or fashion.

We have been doing a series of circuit riders around the country that we feel have proven to be an excellent tool of communicating bonding readiness to minority contractors as well as the principles of bonding.

I want to just go through the problems that we see with the program. As I go over the problems, I do not want anybody in this room, either you, Mr. Chairman, or SBA to think that we are being critical without being constructively critical.

We feel that with just some minor changes, and with some respectful communication with the businessman out there, and a good interchange of information between the Small Business Administration and the entrepreneur, that it could correct a lot of the existing problems.

I would like to start out that we feel that there is a lack of marketing of the Surety Bond Guarantee Program by the Small Business Administration, therefore resulting in potential people not knowing that this program is available. Consequently, minority contractors lose jobs which they could ordinarily obtain, and have the three "C's" to do it, just because they are not aware of the program itself.

Second, we feel that there is a lack of understanding of the program fundamentals by the program recipients including the surety companies and agents, and thereby resulting in the contractor's reluctance to get involved in the program.

Third, for the past 2 years, SBA has taken a series of measures to restrict bonding under the program, which has been below the authorized limits established by Congress. Then the Office of Management and Budget further reduced the guarantee by 10 percent.

Even with this reduction in the guarantee authorization, the SBA program again was underutilized anywhere from 40 to 50 percent.

Fourth, the program was basically designed to assist minority entrepreneurs who lacked the management and financial resources to establish more established businesses. Unfortunately, the program participant criteria is the same used as we would consider in the standard market.

Thus, in our opinion, the criteria used to evaluate the participants is too stringent to meet the objectives and the intent of the program. We look upon this program as a development program. Due to the limits that are set on the bonding, and because of the limits set on the sales that one can have to enter into this program, we think that this should be more or less a development program to develop you to get into the standard bonding.

We feel imposing these kinds of restrictions within the program is somewhat self-defeating. We do not want SBA in any way to be soft-hearted, OK, about it. But at the same time, they have to have more flexibility and more consistency within the program.

We feel that there is a lack of uniformity in the administration and the interpretation of the operation procedures. We get calls and letters in our office asking to intercede as it relates to the interpretation, and as it relates to the administration.

At times, we do intercede, and at times we do not intercede. The times that we do not intercede, we feel that there is good reason for us not interceding, that the information provided by the Small Business Administration has been adequate. But again at times, the information has been inadequate, and leaves the recipient of this proposed service somewhat in frustration.

So we feel again that every time that a bond is lost because of some inconsistency, a minority contractor loses an opportunity.

There also have been a rampant inconsistency of change in policy, and in the interpretation of it. Again, resulting in at any given time, a loss of an opportunity. I think that we also have to look at this in two phases.

When a contractor is turned down as it relates to this guarantee program, not only is a contract lost, OK, but also an opportunity is lost as it relates to jobs; an opportunity for that contractor to elevate himself into larger jobs.

We think that this is very, very important. As SBA moves forward, I think that with some internal training, and not only internal training within themselves, but I think that it is utterly necessary that they communicate with the standard, the specialty, and also organizations such as ours, to try to get maximum input for us before they go into making any kind of policy changes that are going to have a material effect on the contractors out there.

As we can all say, I guess that communication is the backbone and the foundation of any organization. If an organization is going to be good and act as an advocate, and we do declare SBA as an advocate of small business, then the communications in reference to the Surety Bond Guarantee Program are going to have to improve.

Last but not least is that we have also seen where contractors get caught up in what we call a catch-22 situation, where we see that the Surety Bond Guarantee Program is not working either in conjunction and/or complementing the other SBA services, such as the loan guarantee and the 7(j) programs.

We feel that if these programs are able to complement each other more, then we can be much more successful as it relates to the loss ratio, or the denying of bonds to various minority contractors.

Again, I guess that I would like to state for the record that the program is utterly necessary. We see greater utilization for the program in the coming years, and basically because of the Surface Transportation Act.

We hope that this hearing stimulates the SBA officials to say that they have friends out there. To look upon our association as a friend of the Small Business Administration. We have a lot of resources, and we are doing circuit riders throughout the country for the entire year. They have been very well received both by the Government people who we either put them on for and by minority contractors. They have been very well attended.

We have treated the businessman as the chief executive officer in helping them get ready for bonding, and to better understand the principles of bonding. And we feel that this is the kind of attitude that the Small Business Administration with their resources, both personnel and financial, have to take on.

I would like to go back to John again.

Mr. MAGNOTTI. We would like to conclude with what we feel are two positive recommendations to try to improve the program. As Mr. Thomas mentioned, we are also trying to get the word out to our agents through our own network about the need for additional bonding in these particular areas. We feel that these recommendations will help bring the program into some focus in the field.

The first recommendation was really triggered by your question last time as to how we could identify those people who could not get bonds. As any program is depressed, there are a series of people who are deleted from the program, but the problem is that you never know who or how many. And that information is very difficult to get.

We feel that the only efficient way that this information can be gathered is through reporting of those individuals who actually have been turned down. There are more expensive ways. You can run, of course, a series of market surveys, and you might want to ultimately do something like that.

But in the interim, we are recommending that a hot line be established in our association for small minority contractors to report on their experiences in either finding or obtaining bonding. This information will then be used as a basis for this program, which Dewey is going to recommend next.

But the point is that there is no efficient way to get a handle on who has been turned down, except from the person who has been turned down. And we are trying to suggest some method for gathering this kind of information. So that with this positive feedback, we can then do something about it.

Mr. THOMAS. The second recommendation that we have is that we would like to have SBA in some way to be mandated or to establish a circuit rider of outreach programs to provide bonding development assistance to smaller minority contractors.

This can be accomplished by conducting a series of workshops. And again, I do not want anyone to feel that because when you mention the word "workshop" in Washington, that that becomes a buzz word that nothing is going on. I would like to mention this technique as a very, very positive thing, and I say this from experience.

I have myself, personally, over the last 90 days put on at least 15 workshops around the country relating to bonding readiness, and understanding the principles of bonding. And by the letters and feedback, we have been asked to do encores by the Department of Transportation in getting ready for the Surface Transportation Act. I can say emphatically that they have been very successful.

We feel that the following areas should be addressed in the major cities: namely, the principles of bonding, the fundamentals of bonding, identifying and letting the contractor (who again we always address as the chief executive officer) understand the types of bonds, what an indemnification means, how the Miller Act impacts upon his company, understanding the three "C's" and the criteria of bonding, and also understanding the reasons why people go into default in bonding.

Just to show you the kind of information that we have been able to pick up as it relates to default. When we started this circuit rider of workshops around the country, we had five main reasons why bonds default. Now we are up to number 13. We got the others from the contractors themselves. Again, that kind of communication also helped educate us to the facts.

The second part of this circuit rider or the workshop should include bonding readiness. Teaching the contractor to get ready before the eleventh hour. And that is the prequalifying and better understanding the bonding process, understanding what financial management means to bonding, understanding management systems as to what it means to bonding, and understanding the bonding, insurance, and supplier relationship that one must have in order to obtain a line of bonding credit.

The last part, in rushing out of the office this morning, I forgot to bring the book that we had put together and that we use as we go around doing these circuit riders, but we will make it available to the committee as part of an exhibit.

Mr. **Mitchell**. Would you provide enough copies for all of the members?

Mr. **Thomas**. Yes, we will.

And the big thing that we feel is most beneficial to the minority entrepreneurs, the contractor, is that as the chief executive officer, we let him know that he does not relinquish or delegate the need to develop a bonding portfolio. That is something that he must know how to do himself. And where he does not have the expertise, then he will delegate that task to someone knowledgeable.

It is necessary for the majority contractor to do the following: Filling out of the actual surety bonding application, understand the process of the SBA guarantee, understand his personal and business financial records, understand management and personnel detail, provide information concerning actual contract experience, and actual job information.

During this workshop, we help the contractor to actually put together a dummy portfolio so that he can take this portfolio back to his company, adopt it and modify it to meet his own needs. But again, have a very clear understanding of what environment he is going to have to act in, if he is going to be successful.

Then we get into the do's and don'ts in satisfactorily completing the SBA guarantee program, which again would go back to the application and the fundamentals. Now we feel that this kind of work could derive many benefits to the contractor, to the Small Business Administration, and to the community that they are working in.

We feel that this will provide a better understanding of the bonding process. And by a contractor understanding the bonding process, he is going to be able to work more effectively and have more respect. One of the things that we have done as we do these workshops is that we always make sure that we have had a person from the surety industry there.

And basically, we have had some from the specialty and some from the standard. We have that person sit in the workshop as the expert. At the conclusion of the workshop, we ask a very candid question. The question is: If this company now came to you with this portfolio that we have just put together and developed today, would you bond this company?

And I can testify that at each time without any duress, the bonding agent said yes, we would bond this company, if they came to us with a portfolio like this. The only reservation that was made was that we did not develop what is called the project information.

If the project information was OK, along with what I already know about the contractor from the portfolio, we would bond this company. So we think that that is very, very important.

Understanding the environment that one has to work in, and having respect for it. Right now, minority contractors, and again I do not want to say the majority of them, do not have much respect for the surety industry, because number one, they do not understand it. I think that with more understanding that they will develop more respect, and pay more attention to it.

It would create a better working relationship with SBA personnel who are involved in the bonding guarantee program. It would provide the contractor with information to structure his internal business plans and his bonding criteria.

It also would have him create some kind of discipline within his own company to keep a portfolio up-to-date, and to review the portfolio on an annual basis.

We feel that this recommendation, if either adopted or mandated for SBA in connection with the standard and the specialty surety companies, and in conjunction with associations that represent minority contractors around the country, would be a tremendous boost to the program, would be a tremendous boost to the credibility of SBA around the country, and would have the kind of impact that we are locking for with the kind of resources that are available with the Small Business Administration relating to the bond guarantee program.

[The joint prepared statement of Mr. Magnotti and Mr. Thomas follows:]

Joint Prepared Statement of Dr. John F. Magnotti, Jr., Executive Vice President, American Specialty Surety Council, and Dewey Thomas, Jr., Executive Director, National Association of Minority Contractors

MR. CHAIRMAN, MY NAME IS JOHN MAGNOTTI, AND I AM THE EXECUTIVE VICE PRESIDENT OF THE AMERICAN SPECIALTY SURETY COUNCIL. WE ARE HERE TODAY TO MAKE A JOINT STATEMENT WITH THE NATIONAL ASSOCIATION OF MINORITY CONTRACTORS WHOSE EXECUTIVE DIRECTOR, MR. DEWEY THOMAS, JR. IS BESIDE ME AT THE TABLE.

OUR STATEMENT WILL BE RELATIVELY SHORT. I WILL BEGIN BY PRESENTING THE ISSUES AS WE SEE THEM, MR. THOMAS WILL THEN OUTLINE THE PROBLEMS ASSOCIATED WITH THE PROGRAM AS IT IS CURRENTLY BEING ADMINISTERED, AND WE WILL CONCLUDE BY JOINTLY OFFERING TWO MAJOR RECOMMENDATIONS WHICH WE BELIEVE WILL PROVIDE POSITIVE ASSISTANCE TO SMALL CONTRACTORS IN OBTAINING BOND GUARANTEES UNDER THE SURETY BOND GUARANTEE PROGRAM. WE WILL THEN BE PLEASED TO ANSWER ANY QUESTIONS YOU OR THE OTHER COMMITTEE MEMBERS MIGHT HAVE CONCERNING THE PROBLEM AREAS IN THE PROGRAM OR OUR RECOMMENDATIONS. SINCE BOTH OF OUR ORGANIZATIONS APPEARED BEFORE THIS SUBCOMMITTEE ON APRIL 27 OF THIS YEAR TO TESTIFY ON H.R.860 AND 2132, WE WILL NOT REPEAT THE INFORMATION WE PRESENTED AT THAT TIME ON THE SCOPE OF OUR MEMBERSHIP AND ACTIVITIES.

ISSUES

THERE ARE TWO BASIC ISSUE AREAS IN CONNECTION WITH THE SBA'S SURETY BOND GUARANTEE PROGRAM.

THE FIRST ISSUE IS THE NEED TO INCREASE THE UTILIZATION OF THE PROGRAM BY ALL SMALL CONTRACTORS WHO ARE UNABLE TO OBTAIN BONDING IN THE STANDARD MARKET AND IN THE PROCESS TO FULLY UTILIZE THE SBA GUARANTEE AUTHORITY.

THE SECOND ISSUE IS TO DEVELOP A BETTER UNDERSTANDING OF THE PROGRAM BOTH WITHIN THE GOVERNMENT AND AMONG THOSE SMALL BUSINESSMEN WHO ARE POTENTIAL RECIPIENTS AND EQUALLY IMPORTANT AMONG THE AGENTS AND SURETIES WHO EXECUTE THE PROGRAM IN PARTNERSHIP WITH THE FEDERAL GOVERNMENT.

BOTH OF THESE ISSUES WERE DISCUSSED AT LENGTH IN OUR PREVIOUS TESTIMONY SO I WILL NOT REPEAT THAT ENTIRE DISCUSSION IN THE INTERESTS OF TIME; HOWEVER, I WOULD LIKE TO BRIEFLY STATE THAT DURING THE PAST YEAR THERE HAS BEEN AN ALMOST DISASTROUS DECLINE IN THE UTILIZATION OF GUARANTEE AUTHORITY IN THE SURETY BOND GUARANTEE PROGRAM. MANY REASONS CONTRIBUTED TO THIS DECLINE, BOTH WITHIN THE GOVERNMENT AND AS A RESULT OF THE GENERAL ECONOMIC DECLINE SUFFERED BY SMALL BUSINESSES.

BECAUSE OF THE MILLER ACT, IT APPEARS VIRTUALLY CERTAIN THAT THE PASSAGE OF THE SURFACE TRANSPORTATION ASSISTANCE ACT OF 1982 AND ITS REQUIREMENT FOR A 10 PERCENT SET ASIDE OF FUNDS APPROPRIATED BY THE ACT FOR SMALL BUSINESS CONCERNS OWNED AND CONTROLLED BY SOCIALLY AND ECONOMICALLY DISADVANTAGED INDIVIDUALS WILL CREATE A DRAMATIC INCREASE IN DEMAND FOR BONDING. WE ANTICIPATE THAT THIS DEMAND MIGHT WELL GO BEYOND THE GUARANTEE AUTHORITY LEVELS CONTAINED IN H.R. 2132. THIS INCREASED DEMAND THEN CREATES THE BASIS FOR THE SECOND MAJOR ISSUE AND THAT IS THE DISSEMINATION OF INFORMATION ABOUT THE PROGRAM TO THE SMALL BUSINESS COMMUNITY, MOST PARTICULARLY FIRMS OWNED AND CONTROLLED BY SOCIALLY AND ECONOMICALLY DISADVANTAGED INDIVIDUALS. A COROLLARY TO THE ISSUE OF DISSEMINATION TO THE SMALL BUSINESS COMMUNITY IS THE DISSEMINATION OF INFORMATION ABOUT THE PROGRAM AMONG GOVERNMENT OFFICIALS TO ENSURE MAXIMUM UTILIZATION OF THE PROGRAM WHEREVER POSSIBLE IN ALL GOVERNMENT CONSTRUCTION PROGRAMS.

I WILL NOW DEFER TO MR. THOMAS WHO WILL DISCUSS THE PROBLEMS CURRENTLY BEING EXPERIENCED IN THE IMPLEMENTATION OF THE SURETY BOND GUARANTEE PROGRAM.

(DEWEY THOMAS COVERS PROBLEMS)

PROBLEMS

1) THE THRESHOLD OR MAXIMUM BONDING LIMIT AS ESTABLISHED IN THE MILLER ACT HAS BECOME OUTDATED, INAPPROPRIATE AND INCONSISTENT WITH THE INCREASED CONSTRUCTION COST OF 1983. THE CURRENT THRESHOLD LIMITS SMALL AND NEWLY ESTABLISHED CONSTRUCTION ENRTEREPRENEURS FROM MARKETING AND SECURING "SMALL" CONTRACTS. THE CURRENT THRESHOLD FURTHER LIMITS THEIR OPPORTUNITIES TO BUILD THE TRACK RECORDS, FROM UNBONDED WORK, TO ULTIMATELY MEET THE EXPERIENCE CRITERIA FOR SEEKING "LARGER" BONDED CONTRACTS.

2) THE LACK OF MARKETING OF THE SBG PROGRAM RESULTS IN MANY POTENTIAL USERS BEING DENIED BONDED CONTRACT OPPORTUNITIES WHICH THEY OTHERWISE WOULD HAVE RECEIVED IF THEY WERE AWARE OF THE SBG PROGRAM.

3) THE LACK OF UNDERSTANDING OF THE SBG PROGRAM FUNDAMENTALS BY THE PROGRAM RECIPIENTS, INCLUDING THE SURETY COMPANIES, AGENCIES AND CONTRACTORS RESULT IN UNDER UTILIZATION AND A RELUCTANCE TO PARTICIPATE IN THE SBG PROGRAM.

4) FOR THE PAST TWO YEARS SBA HAS TAKEN A SERIES OF MEASURES TO RESTRICT BONDING UNDER THE SBG PROGRAM BELOW THOSE LIMITS ESTABLISHED IN CONGRESS. THE OFFICE OF MANAGEMENT AND BUDGET FURTHER REDUCED THE AMOUNT OF THE GUARANTEE BY TEN PERCENT. EVEN INCLUDING THE REDUCED GUARANTEE AUTHORITY, THE SBG PROGRAM HAS BEEN UNDERUTILIZED BY BETWEEN FORTY AND FIFTY PERCENT.

5) THE BASIC SBG PROGRAM IS DESIGNED TO ASSIST SMALL AND MINORITY ENTREPRENEURS WHO LACK THE MANAGEMENT AND FINANCIAL RESOURCES OF MORE ESTABLISHED BUSINESSES. UNFORTUNATELY, THE SBG PROGRAM PARTICIPATION CRITERIA IS THE SAME AS THOSE USED BY THE BONDING INDUSTRY TO EVALUATE LARGE FIRMS. THUS, IT IS OUR OPINION THAT THE CRITERIA USED TO EVALUATE SBG PROGRAM PARTICIPANTS IS TOO STRINGENT TO MEET THE OBJECTIVES OF THE INTENT OF THE PROGRAM.

6) THE LACK OF UNIFORMITY IN THE ADMINISTRATION AND INTERPRETATION OF THE STANDARD OPERATING PROCEDURES THROUGHOUT THE TEN REGIONS OFTEN RESULT IN FRUSTRATION AND CONFUSION BY THE SURETY AGENTS AND COMPANIES AND FURTHER RESULTS IN "LOST" OPPORTUNITIES BY THE CONTRACTOR RECIPIENTS.

7) THE RAPID AND INCONSISTENT CHANGES IN POLICY AND POLICY INTERPRETATION HAVE RESULTED IN THE CONTRACTORS, SURETY COMPANIES AND AGENTS NOT KNOWING WHAT THE RULES AND CRITERIA ARE AT ANY GIVEN TIME.

8) THE LACK OF COMMUNICATION WITH THE SBG PARTICIPANTS BEFORE MAJOR PROGRAM ADJUSTMENTS ARE MADE OFTEN RESULT IN POLICY AND CRITERIA WHICH IS INCONSISTENT WITH THE INTENT OF THE PROGRAM AND ARE CONTRARY TO THE NEEDS OF THE PARTICIPANTS.

9) THE SBG PROGRAM FUNCTIONS WITH TOO MUCH AUTONOMY AND DOES NOT COMPLIMENT OR WORK IN CONJUNCTION WITH OTHER SBA PROGRAMS, SUCH AS THE LOAN PROGRAM AND THE 7(j)10 PROGRAM.

MR. THOMAS AND I HAVE TWO RECOMMENDATIONS WHICH WE WOULD LIKE TO OFFER JOINTLY TO THE COMMITTEE FOR CONSIDERATION. I WILL DISCUSS THE FIRST OF THE RECOMMENDATIONS AND MR. THOMAS WILL CONCLUDE OUR TESTIMONY WITH THE SECOND.

THE FIRST RECOMMENDATION IS THAT THE SBA IN COOPERATION WITH OUR TWO ASSOCIATIONS AND ANY OTHER INTERESTED GROUPS DEVELOP A BETTER STATISTICAL BASE FOR DETERMINING THE EXTENT OF PARTICIPATION OF VARIOUS GROUPS OF SMALL BUSINESSMEN IN THE PROGRAM. THE SBA AT THE PRESENT TIME DOES, IN FACT, CREATE A VARIETY OF REPORTS ON THE PROGRAM, BUT THEY ARE AFTER-ACTION REPORTS. AS I STATED IN MY TESTIMONY SEVERAL WEEKS AGO, WHEN GOVERNMENT PROGRAMS ARE DIMINISHED, POTENTIAL RECIPIENTS ARE DELETED FROM PARTICIPATION IN THE PROGRAM. THE PROBLEM IS THAT NO ONE KNOWS WHICH RECIPIENTS AND HOW MANY HAVE BEEN DELETED. IN THE SURETY BOND GUARANTEE PROGRAM, THE ONLY EFFICIENT WAY THAT THIS INFORMATION CAN BE GATHERED IS THROUGH REPORTING FROM THOSE INDIVIDUALS WHO HAVE ATTEMPTED TO OBTAIN BONDING AND FAILED FOR WHATEVER REASON. WE RECOMMEND, THEREFORE, THAT A "HOT-LINE" BE ESTABLISHED IN THE AMERICAN SPECIALTY SURETY COUNCIL FOR SMALL AND MINORITY CONTRACTORS TO REPORT ON THEIR EXPERIENCES IN EITHER FINDING OR OBTAINING BONDING. THIS INFORMATION WILL THEN BE USED AS A BASIS FOR THE PROGRAM WHICH MY COLLEAGUE WILL NOW PROPOSE.

RECOMMENDATIONS

IT IS RECOMMENDED THAT CONGRESS ESTABLISH TIGHTER CONTROLS OVER THE MANAGEMENT AND IMPLEMENTATION OF THE SBG OPERATING PROCEDURES TO INSURE THAT THE INTENT OF THE LEGISLATION WHICH ESTABLISHED THE SBG PROGRAM IS MET.

IT IS FURTHER RECOMMENDED THAT SBA BE MANDATED TO ESTABLISH A "CIRCUIT RIDER OUTREACH PROGRAM" TO PROVIDE BONDING DEVELOPMENT ASSISTANCE TO SMALL AND MINORITY CONTRACTORS. THIS CAN BE ACCOMPLISHED BY CONDUCTING A SERIES OF WORKSHOPS TO BE HELD IN MAJOR CITIES THROUGHOUT THE COUNTRY. THE "CIRCUIT RIDER OUTREACH PROGRAM" WORKSHOPS WILL FOCUS ON THE FOLLOWING:

I. PRINCIPLES OF SURETYSHIP
  A. FUNDAMENTALS OF BONDING
  B. TYPES OF BONDS
  C. INDEMNITY
  D. THE MILLER ACT
  E. UNDERWRITING CRITERIA
  F. MOST COMMON REASONS FOR BOND DEFAULT
II. BOND READINESS
  A. PREREQUISITES AND A BETTER UNDERSTANDING OF THE BONDING PROCESS
    1. FINANCIAL MANAGEMENT
    2. MANAGEMENT SYSTEMS
    3. BOND,INSURANCE AND SUPPLIER RELATIONSHIPS

B. BOND PORTFOLIO PREPARATION

1. SURETY APPLICATION
2. SBA-SBG APPLICATION/PROCESS
3. BUSINESS AND PERSONAL FINANCIAL DATA
4. MANAGEMENT AND PERSONAL DATA
5. CONTRACTING EXPERIENCE
6. PROJECT INFORMATION

III. THE DO'S AND DONT'S IN SATISFACTORILY COMPLETING THE SBA SURETY BOND GUARANTEE APPLICATION.

A. THE APPLICATION

B. THE SBG PROGRAM FUNDAMENTALS AND CRITERIA

EACH WORKSHOP WILL PROVIDE PARTICIPANTS WITH REFERENCE MATERIALS INCLUDING A BONDING MANUAL WITH SAMPLE FORMATS THAT WILL ASSIST THEM IN MEETING GENERAL BONDING REQUIREMENTS. THE DIRECT BENEFITS TO THE PARTICIPANTS ARE AS FOLLOWS:

1. BETTER WORKING UNDERSTANDING OF THE BONDING PROCESS
2. BETTER WORKING UNDERSTANDING OF THE SBG PROGRAMS
3. INFORMATION TO STRUCTURE THEIR INTERNAL BUSINESS PLANNING TO MEET BONDING CRITERIA
4. INFORMATION TO STRUCTURE A COMPLETE BOND PORTFOLIO.

Mr. **Mitchell**. Thank you, for a very well thought out idea. I want to start out by complimenting both you and Mr. Magnotti. First of all, Mr. Magnotti, in terms of your recommendation of that hot line procedure to be handled by The American Specialty Surety Council.

I think that this is what many people are looking toward, the private sector taking on a great deal more responsibility in making things work in this country. And I certainly want to compliment you, it is an excellent recommendation.

I would hope that the subcommittee members who are not here will pay particular attention to that recommendation. It is interesting that in my own State of Maryland, a program has just been devised, involving the bonding companies and another entity called the Council for Equal Business Opportunity, to try to break through this enormous barrier of bonding.

I certainly want to compliment you and Mr. Thomas for an excellent delineation of what needs to be done. Based on your circuit riding, you have proved that it has been done.

I have a couple of questions. First of all, you are going to help us build the data base, if this recommendation is accepted by SBA or by the subcommittee? And I think that it is excellent.

We are working in the dark so many times. We really do not know figures. I just think that that is excellent. But the question that I wanted to raise was with reference to marketing the program, the Surety Bond Guarantee Program.

Both of you have been somewhat critical that the information is just not out there. I would assume, and Mr. Sanders will testify later on, I will assume that he might testify to the effect that there are so many demands now placed on SBA, and there has been a reduction of personnel, that they might have some difficulty in doing a good job of marketing the program. He might testify to that effect, I do not know.

In the event that he does, what is another option for getting the word out. You are doing it through your association, through your circuit riding.

What other options could we pursue?

Mr. **Magnotti**. What we had really intended to do is to propose that we do a joint marketing program, and that is what we will propose to the SBA. And Mr. Thomas is developing that now, which we will then participate in.

What we would like to do is have a joint operation out there, where we have our agents involved, standard agents, if possible, and certainly minority contractors, and possibly subcontractors, and whoever else can get into this thing, and have major presentations in cities where the subcontracting or the construction is most intense.

Mr. **Mitchell**. Now Mr. Thomas has done that in how many cities?

Mr. **Thomas**. Over the last 90 days, it has been in 12 of the major cities.

Mr. **Mitchell**. Twelve major cities?

Mr. **Thomas**. Right.

Mr. **Mitchell**. And that is without the partnership?

Mr. **Thomas**. Yes, right.

Mr. **Mitchell.** Why then do you want the partnership, since these have been successful?

Mr. **Thomas.** We feel that we could expand then. We feel again with the SBA having national recognition, that a combination of them would lend credibility to these workshops, knowing that at the end of the rainbow, there may be a pot of gold. I think that that is always an incentive.

And it would also, you know, help to bring John and I together in relationship to exactly what we are doing here today. So we feel that with the SBA actually having the program, that we could help out with the overall utilization of the program.

In our newsletter which I have here, for instance, every month we run a bonding article. We feature different companies that are doing things in the bonding industry in relation to minority contractors. We could devote just a page to the SBA program. Again, letting people know what is the criteria, and what they can get under the program.

Mr. **Mitchell.** What is your membership?

Mr. **Thomas.** 2,500.

Mr. **Mitchell.** That means that we are still reaching a relatively small segment just through your newsletter.

Mr. **Thomas.** The newsletter is mailed out to 3,000.

Mr. **Mitchell.** 3,000?

Mr. **Thomas.** Right.

Mr. **Mitchell.** We are still short then, enormously so.

Mr. **Thomas.** We are short 90 percent.

Mr. **Mitchell.** I am going to direct this next question to Mr. Meushaw, but both of you gentlemen can respond.

Mr. **Thomas.** If I could just say something?

Mr. **Mitchell.** I am sorry.

Mr. **Thomas.** Yesterday, I had the opportunity to meet with one of the newer presidents of a local bank here. And we started talking about small business, because this bank is really in tune to small business. And we started talking about the SBA guarantee, the loan program.

He was very, very complimentary about the loan program. He asked us what was our reaction to the program. Again, he was very, very complimentary about it. But one thing that he said, and because Mr. Sanders is here, I would just like to use this opportunity to bring this to his attention, he said that his program within his own bank could work so much more effectively if he started receiving information back from SBA in relationship to how the program is going around the country, what are the other banks doing, what kinds of problems are they having. Maybe once a year calling the different bankers together in Washington to discuss the program. He said that that kind of outreach would have a tremendous effect on his staff, and also in their posture and position as they move on, and develop their annual plans.

So again, it gets back to that communication that does not cost anybody a lot of money, but is so necessary to get the private sector involved.

Mr. **Mitchell.** All right, let me get to my other question, one of my others. And that is you established your three "C's." The third one was character. I always worry when we get into what could be a highly subjective area.

I jumped a little bit when both of you made reference to character, only because I know of a very successful firm that does not need SBA or anybody else. But this owner of the firm served a prison sentence for a felony 10 or 15 years ago. He came out, and he has been successful.

Now under a very stringent definition of character, the fact that he had been in conflict with the law at one point in his adult life might make him a bad character with reference to the bonding program.

I do not know if it is possible to be less than subjective when you deal with character. But I just want to point out that I have some concerns about an overuse of that, or an overly stringent interpretation of what character means.

What did you have more precisely in mind, Mr. Meushaw?

Mr. MEUSHAW. I think historically the point that you are making, we are freeing up, and becoming more open about the word character. For instance, there was a case not too long ago in Virginia where a lady wanted to become a member of the bar association, if you recall, and there was something about maybe she was living with a man. And eventually, I think that the bar association ruled that she could be admitted. So I think that we are becoming more open. I find nothing wrong if you have got a good man, and he has served time in the Maryland penitentiary 10 years ago, but he is a darned good carpenter, et cetera, working for me, and so on, and so on, and certainly he has proven himself for a period of time, and the fact that he had gone to prison prior to that. On the other hand, I am not too sure. The whole theory of surety is to answer for a debt of another. And I am not too sure that if someone came out of the Maryland penitentiary and was a burglar, that as a surety that I would want to write him.

Mr. MITCHELL. I guess that I have been burned so many times by over stringent regulations, and the interpretations made by lower level persons in government with regard to a broad subjective area like this.

The wrong interpretation by anyone in SBA, or in any one of the other agencies could become another obstacle really in blocking the effectiveness of the Surety Bond Guarantee Program. It could be.

Mr. Thomas, could you give me an illustration or two? You referred to the inconsistencies in changing policies with regard to the Surety Bond Guarantee Program in your testimony, and pointed out that that caused a great deal of difficulty out in the field.

Could you cite me some of the inconsistencies or rapid changes in policy?

Mr. THOMAS. Over the last 6 months, we have received, and I have some letters to attest to it, calls from members of our association where either they had problems with the agent processing their package through the guarantee program and/or they felt that they had some direct problems. Most of them had come out of the Atlanta office. That they had some problems with the program in general.

We have tried as much to stay out of it. Because the way things change and the way that personnel changes, that we do not feel that we could make a positive impact on it. So when these inquiries do come in, the thing that we have been doing is calling the district office that has had this complaint.

And in calling that district office, we have found that if we call another district office, we will get a different interpretation of some of the criteria, or how much money is available, or what is the process that they have to go through.

I always ask our members: Did you actually get a list, or did you get an item of what is required in the program? It is no, or some of them say yes, I did get it. Then I tell them to go back and get it. It seems like one of the first steps that either the agent or whoever that first person they contact about the SBA program, that they actually receive some kind of criteria form that the SBA has either imposed within the program, so that they will have a better understanding, and know what kind of process that they will have to go through.

We just got through with one with the VA down in the Atlanta area, where we were having a terrible time trying to get some consistent information out. We were up against it, because this contractor was applying for a bond close to $1 million. He had not received that kind of bond in the past, and there just seemed to be a lot of hesitation.

Then we ran into the problem where he did have a SBA loan. And we were trying to get one thing subordinated versus the other. And we are just not able to get to the person that would make that kind of decision. It was always well, I cannot do that. You will have to do it with so and so.

And I just think that they have to be more definitive in their communications.

Mr. MITCHELL. I think that I misread you. I thought on page 7, that you were referring to rampant and inconsistent changes in policy interpretation made by the SBA.

Mr. THOMAS. I think that John would have more experience with that.

Mr. MAGNOTTI. What we are talking about here, there is a concept which I am sure has been mentioned before called post of duty, where the SBA in Washington would in fact control the SBA officials in the field. They do not now do that. They do not have hire/fire control.

So when the SBA in Washington puts out a policy, there are various interpretations made of that policy in the various regions around the country. In some cases, you develop almost a warlord mentality.

Where a regional SBG director will say I am just not going to do that. And there is not too much that you can do to that individual in terms of removing him or correcting him, except and unless you go through his hierarchy, which means going through the regional structure to get to him through the Regional Director.

We can come up with specific cases where there have been different interpretations, for example, of the financial statement requirements. The SBA SBG program put out a policy, for example, that said review type statements were required. And I know that the people in Washington went to great pain and at great length to explain that this was not the review statement required by accountants, but was a review type of statement in order to provide certain information for individuals.

In some regions this was considered to be an accountant type statement, and in other regions it was considered differently. We had one instance where the word got out that someone at SBA in national had suggested a change in policy. Somehow this got out as a change in policy, and was adopted by one office in a particular city, not even in a regional center.

And all of a sudden, we got a call that said what is happening here, there has been a change in policy. It was not a change in policy. It was suggested by someone, and was not adopted.

But the perturbations in the system are such that it is difficult to control from Washington. And besides that, in the budget crunch, when they were trying to ratchet the program down, there were certain policies put into place which ratcheted so far that they had to be changed almost immediately.

So there was a great push and tug over this last year that resulted in this 50-percent utilization of the program. Those are the kinds of inconsistencies that we are talking about.

Mr. Mitchell. I do not know how you are going to clean that one up. I have had my own experience along those lines, too, in terms of a misinterpretation or a varying interpretation of policy. And I just do not know how you do it. Perhaps Mr. Sanders can help us out when he testifies on that.

Just one other observation, and then one last question. I like the idea of your workshops. And like you, having been around Washington as long as I have, I sort of look at workshops with kind of a jaundiced eye. You come and get doughnuts and coffee in the morning, and then break for lunch.

But a good workshop is a very necessary, I think, tool to help implement and facilitate government programs. I put on some myself. And one of my problems is that with small businesses, it is so difficult to find that day that they can participate in a workshop.

A guy wants to be out there with his business. And every hour that he is away from his business, he thinks that he is losing money. I had that problem as to what is the best time at which to do it.

And the second part of my problem is how do you reach beyond that circle of small businesses and minority businesses that have a degree of sophistication and the money to come to a workshop, how do you reach beyond that group when there is another 40,000 people out there that do not have time, nor the money, or it is a bad day.

Mr. Magnotti. This is not a panacea, but a suggestion. Certainly everybody who works in government contracting reads the Commerce Business Daily.

Mr. Mitchell. I am not at all sure that everyone does.

Mr. Magnotti. They at least ought to. In any event, that is one approach. The CBD is as universal, I think, as anything that you can find in terms of a procurement publication. And we are considering trying to publish in that as part of this process.

Mr. Meushaw. When you speak of time, Congressman Mitchell, we always try to start it at 10:00 in the morning, run it through 3:30, which gives them an opportunity to go into their office in the morning or their shop, get set up, leave, come to the workshop, and then be able to go back to their shop at the end of the day.

When we send out our flyers, we articulate that, that is why we structure it like that. To give you an example that happened in Detroit just two weeks ago. One contractor who I had never seen before and did not know came in. He stayed for the introductions and whatnot. And when we got ready to break for that infamous coffee break, I saw him heading out the door. So I said to myself, I am not going to let him go.

I went to the door, and said how come you are leaving. He said well, I have got a lot of things that I have got to do, I said, I will tell you what, I will make a deal with you. I said if you stay for the remainder of the day, and you say that this was not worth it and I wasted my time, you get a year's free membership in our organization.

I said if you stay, and you say hey, I have got to do things outside my business, and develop resources outside of my shop, then you have to pay to become a member of our association. I got his check the other day. He said he stayed, and that it was some of the best time he had ever spent outside of his shop.

So I just use that as just a little scenario to also let people who are working, people who are minority businesses, know that they have to spend some time outside of their shop to develop those resources that will impact on their shop. It is an educational process.

Mr. **Mitchell**. I understand, and I am sympathetic. But that guy who is a five-man shop, it gets awfully tough for him to pull out from it.

My last question, is just based on some feedback that I have gotten from contractors. They are small, and they do not keep very detailed records. Some of them do not run a sheet each day. They run it during the course of the week, sometimes forgetting things that happened on Tuesday. Nevertheless, they get a report in.

Some of them have complained that the surety industry in order to do an investigation of them demands very detailed records, detailed, accurate complete financial business records. A small shop, five guys, might not have that kind of detail that a surety would need to do an investigation.

What has been your experience along those lines? Has it been a problem that a guy would not get bonding simply because he does not have enough detailed accurate information to even allow for a good investigation?

Mr. **Magnotti**. In the initial stages of the program, I was not involved. But as I understand it, there was an understanding that the program was to bond higher risk contractors, exactly the kind of person that you described. Where working with one, or two, or three people, he has difficulty keeping financial statements.

Bonding was accomplished then. And under those circumstances, your loss ratio is going to be slightly higher than it is in the standard markets. But through a series of events, which tended to frighten in many cases the people involved, they began to tighten the screws on financial statements in particular.

And as they tightened the screws, they became more and more like the requirements imposed in the standard market. And what you are describing is in fact occurring, and it occurs because of the requirements in the SBA where they require certain types of financial statements.

Now our people are not just going to bond anything either. But they were willing to understand the informality of the system, as long as that is acceptable to the people that they are bonding through, the SBA.

Mr. MITCHELL. Mr. Meushaw, do you have any comment on that?

Mr. MEUSHAW. I was just going to say, and I mentioned the mid seventies before. And again, in my company, we needed more complete statements. No longer could you use nonaudited statements. They had to be audited, and so on.

So yes, I think that the screws are on. That more information is needed. I did not see that as a problem, however, to the minority contractor, if the surety salesman will take maybe an hour, and explain the forms to him.

Mr. MITCHELL. Do you have any comment?

Mr. THOMAS. No, no comment.

Mr. MITCHELL. Gentlemen, thank you, very much. I have other questions, and I always do. But I will forego them for now. Thank you.

Our next witness is Mr. Jack Marchbanks, Minority Development Financing Board; and Mr. Charles Colbert, president of a minority construction firm. Mr. Marchbanks is not here.

Is Mr. Colbert here?

Mr. COLBERT. Yes.

Mr. MITCHELL. Yes, we will take your testimony next then, Mr. Colbert. Mr. Colbert, we have a copy of your statement, and that entire statement will be submitted for the record. Therefore, if you would just go through, and give us the high points of your written statement, we would appreciate it.

And before you proceed, I would ask unanimous consent that a statement for the record be submitted by Congressman Addabbo:

OPENING STATEMENT OF HON. JOSEPH P. ADDABBO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman, I regret that I am unable to participate in these investigative hearings pertaining to SBA's Surety Bond Program. As Chairman of the Defense Appropriations Subcommittee, I must chair a hearing at this time. I would ask that this written statement be submitted for the record.

Under the Small Business Investment Act, SBA is authorized to guarantee up to 90 percent of loses sustained by a surety as a result of the issuance of a bid, payment, and/or performance bond, SBA may not guarantee any contract whose face value exceeds $1 million. Beneficiaries of this program are the small and minority contractors who would be unable to secure bonding from a surety without a guarantee by SBA.

Invariably, the inability of a contractor to secure bonding results in a loss of contracts. Thus, the bidding process becomes a prerequisite to bid on a contract. It is the assistance provided by the surety bond program that becomes of critical importance to small and minority contractors who are capable of performing the contract, but lack the track record and experience required by a surety.

I am hopeful that these hearings will address the advantages of the Surety Bond Program as well as the problems small and minority contractors have confronted with regard to the intricacies of the bonding process.

TESTIMONY OF CHARLES COLBERT, PRESIDENT, COLBERT REFRIGERATION, INC.; ACCOMPANIED BY FRANCIS X. GAEGLER, ATTORNEY, AND JOHN S. WOOD, ATTORNEY

Mr. **Mitchell.** Please identify the two gentlemen with you for the record.

Mr. **Colbert.** I am sorry, sir.

Mr. **Gaegler.** My name is Francis X. Gaegler, I am an attorney at law, and I have represented Charlie for the last year.

Mr. **Wood.** My name is John Wood. I am a private business attorney. And I hope with the results of what comes out of this, that I will be able to revive this small business concern, and assist him in becoming a viable business entity again.

Mr. **Mitchell.** All right. It is good to see you again. Before you proceed, let me sort of establish some ground rules.

Is there litigation going on right now with regard to Mr. Colbert, are you in court on an issue?

Mr. **Gaegler.** Yes, we are.

Mr. **Wood.** There is litigation going on in court, but we are not here to discuss the court matter in any aspect whatsoever.

Mr. **Mitchell.** I wanted to make sure that nothing in your testimony would relate directly to any matter that is before the court. I think that that would not be helpful.

Mr. **Wood.** We understand that fully.

Mr. **Mitchell.** Fine, thank you. Now that you have got all of the preliminary matters out of the way, please proceed.

Mr. **Wood.** I would like to make a brief opening remark, if I may. As a private attorney for the small business concern, I am usually called instead of the coroner to pronounce the small business concern dead, and then to dispose of the remains.

In that capacity, I find myself dealing with those contractors who know about this program, who have been accepted by some surety, and who also participate in the bonding procedure.

What usually happens with the persons that I am involved with is that these persons are located through either some of the minority associations or by the subcontractors that they deal with, and are then chosen by a prime or general contractor to perform some percentage of the mandatory minority participation.

These persons are introduced to a surety, who makes sure that they are given bonding. They are placed on the job. They perform the job. They are later either driven from the job, or forced into breach, actual or imagined. They are dislocated from the job. The surety performs the job either through a takeover contractor, or he makes an agreement with the prime contractor.

The job is finished. The surety then comes to SBA with his vouchers, and is paid. The contractor walks away with his contract price, the surety is held harmless, and the small business concern is left in the morgue, and SBA is then out of a large amount of money, and completes the job for the owner.

My concern then becomes that we would like to see a greater coordination between the bonding program and the SBA loan program as well as a continuing coordination with the financial institution.

In Mr. Colbert's case, he has a banker who is willing to go to the ends of the earth to assist him other than just giving him the money.

We would also like to see that the purpose envisioned by the SBA bonding program becomes to assist the small business concern. I have been led to believe that the people who administer this program believe that the program is designed to help the sureties, and to see that the surety loses no money on this job, and that they work diligently to that end.

Mr. Gaegler, who is working with Mr. Colbert, will allude to some specifics along this line. But that has been my experience in attempting to find out what, if anything, SBA is willing to do in order to assure that this minority or small business concern first prevent a breach; and second, is able to avoid a default; and third, completes the contract.

The percentages seem to be that there is an announcement by the general contractor that this man is in default. The surety affirms that there is a default, ousts the small business concern, completes the contract, is paid by the SBA, and he walks away being held harmless.

This really gives me some major concern, and this is what I am here crying out against. When we speak of character, as I see it, we are not asking you to assist the man who cannot do the job. If he cannot, hold him in breach, and oust him.

I see character as first the manifest desire on the part of the small business concern, and a willingness to perform his contractual obligation in the face of adversity and disappointment. And many of these contractors would finish the job, if given the assistance.

Those of us who are familiar with the contracting business know that there are delays. There are errors in the drawings, there are mistakes in the regulations, et cetera. We live in a very difficult world. But we do not want to be continuously ousted when 95 to 98 percent of the job has been finished, and you are down to the point where you could walk away with your profits, and you are ousted from the job, and the profit is divided up between whomever.

And that is the kind of relief and complaints that we are raising today.

Mr. **Gaegler.** Congressman Mitchell, Colbert's case represents the worst act of discrimination that is possible, and the lack of understanding by Congress, this committee, and SBA on what Congress really meant to do with the SBA bonding program.

I heard a $1.6 billion, and it is a viable recommendation. I think that the bond should go directly, or the guarantee should go directly to the contractor bypassing the bonding company completely. It is a method, and I have been out here 26 years, so it is not the first time that I have come across it.

Let me give you a case method without alluding to any type of work method. A minority is sought out under the law in these Federal programs and certainly the Surface Transportation Act is not going to be any exception. because he is a minority. They have to fulfill the requirements of the Federal law.

In Colbert's case, all three instances occurred. He was sought out as a mechanical contractor, because he was a minority, and he had a track record that he could deliver. He went on the job. Whether it was the white contractor, whether it was the help that he employed as whites, or whether it was his competition, and I heard all three of them, and this is not guesswork, and especially in this Metro area, and especially in the Metro itself, that he was treated as a fourth class citizen, not even a third.

Now you cannot see that from that platform over there, but I have. In his case, he kept records. In his case, he was abused not only within the organization of contractors, of white contractors who use this front, and made mockery out of Colbert.

Mr. **Mitchell**. You say that they used him as a front?

Mr. **Gaegler**. Used the front of the bonding program, or of the minority program. But in addition to that, SBA itself as late as 1 month ago—and let me allude, because your prior statement was about litigation—we are not involved in direct litigation with SBA.

SBA tells me that there is nothing that I can do about the bond program, we do not have the help. One million dollars of U.S. Government money was given away, $1 million, by the fact that they did not have the help.

Now I have heard generalities this morning about well, we need communication. Well, let me tell you how simple that communication can be. Colbert goes into SBA, and says listen, Metro over here has a contract for $750,000. They came to me because I was the minority, and I have done the work before. Fine, we all understand that thought. He goes to SBA, and SBA says why do you not go up and see this bonding company in Baltimore. They refer him. Now at that point, I understand the rules and regulations of SBA to assist, to aid, to cooperate, even if there is a default, to make the contractor viable. The bonding company comes on down. They fill out some forms, and get a SBG number, and they go on from that point. I do not mean to take too much time, because I understand that I am restricted.

Mr. **Mitchell**. That is all right. I will let you know when.

Mr. **Gaegler**. So they come on down here, and there is a discourse between the agent and SBA. And the discourse goes something like this. Well, Colbert does not have that track record as far as the capital is concerned, et cetera, et cetera. Now the lending or the loan program does not seem to work in conjunction with the bonding program for some unapparent reason.

In Colbert's case, they give a bond. From that point on, they deny any responsibility at all. They are not only a partner, they are a majority partner. Uncle Sam has in most instances 90 percent, or at least 80 percent of that bond.

And what are we told by SBA? They do not have the personnel. Their rules and regulations which were passed in 1973, and which Congress knows about, states that SBA is to assist, to aid, to implement, and to bring in that small businessman when there was a problem.

I do not care if it was the loan once they bonded him, I do not care if it was a default; they were to bring him in, and sit down and talk to him. In Colbert's case, SBA never did that.

Very seldom do you have a subcontractor come before you. In this case, we reconstructed his records. It was not a guesswork situation. We went from A to Z. I lived with this man for months. The actual wrong that was done in this case was due directly to the fact that Colbert was a minority, and that is why I am here, not because of any case.

It was so wrong that SBA said listen, it is the bonding company's responsibility. Mr. Congressman, I do not think that SBA can delegate the legal responsibility to a bonding company of having them sue the subcontractor, the very minority that SBA stood out to help.

And in this case here, Mr. Congressman, I am going to tell you the way that I feel about it. The $1.6 billion is not going to go into the hands of helping minorities. I have seen this on a case by case situation.

It is one thing to sit in these halls, but it is another thing to get on those streets, and to see what happens in this situation. You have heard allusions to the fact, well, they do not keep records. They have certain characters.

Such was not the case of Colbert. Colbert had one fantasy. He was American. And that fantasy from the time that he was in Korea was the fact that he wanted to be someone and somebody. He was willing to sacrifice, and he was willing to do all of the things that were necessary to fulfill those requirements except one.

Mr. **Mitchell**. As I understand the burden of the statement that you made is that in your opinion, the SBA abandoned its responsibility.

Mr. **Gaegler**. Absolutely.

Mr. **Mitchell**. Just hear me out.

Mr. **Gaegler**. I am sorry.

Mr. **Mitchell**. After locating a minority contractor in terms of the conflict that that contractor was having with the bonding company. Is that correct?

Mr. **Gaegler**. Not quite. They abandoned their responsibility after they gave him the bond.

Mr. **Mitchell**. Yes, OK. And I know your case, and I am trying scrupulously not to get into it.

Mr. **Gaegler**. I have not alluded to it per se in that area.

Mr. **Mitchell**. Excuse me, just 1 minute.

[Pause.]

Mr. **Mitchell**. I wanted to check with counsel just to refresh my own mind. Because I think that over the past year, I can recall independently about a half dozen cases in which a minority contractor working with SBA got the contract and got a bond.

There is an interesting thing that has happened in these half dozen cases that I know about, and there may be more, I do not know. That is when the job is about 70 to 80 percent complete, that is when something goes wrong, the minority firm is dropped.

Now, Attorney Wood, has that been your experience?

Mr. **Wood**. That is absolutely what we are speaking on.

Mr. **Mitchell**. Why do you think that that happens?

Mr. **Wood**. It is profitable. There is no motivation on behalf of the surety to deal with a person who he does not want to deal with anyway to go on and assist this man to the end of the project.

The prime contractor does not find this profitable. Because if he could either perform this work himself or through his own control subcontractor, the profit can be taken off. When you put up a shell corporation, you put a minority in and say that he is president of this corporation, you can give him $75 a week and be satisfied.

We are talking about in the case of Mr. Colbert, that some contracts were as high as $850,000 which he was performing. And if you siphon the profit off of that, and give this to the prime contractor, you are talking about an interesting bit of money.

So there was no motivation to first let this man walk away from the profit. There is the eternal discrimination to say that he is not entitled, nor does he deserve to walk away from a $225,000 profit. And it is not profitable for the surety to bear with this when he can walk into the SBA, and say I lost money on it, and this is what I need.

And if you look at one of the instances when they send the voucher over to SBA, to say at least compromise this bond for $480,000, the prime contractor took the $480,000, and walked away, and never even completed the job himself.

So it is that kind of thing that is allowed, because SBA does not follow through on the regulations that you have in position right now.

Mr. MITCHELL. This is very unusual, but I have been sort of tormented by these six cases that I know about. And let me say if there were just one case, I would say that is just one case.

But I want to interrupt, and ask Mr. Thomas from the audience a question. The issue that we are trying to deal with, and I am asking you this because you head up the association. I had said earlier, and I do not know if you were in the room or not, I have knowledge of a half dozen cases, that is personal knowledge, where the minority firm got the contract, got the bonding. But at 70 percent of completion of the job, or at 80 percent of completion of the job, for one reason or another, that party was dropped.

Have you had that experience with members of your association?

Mr. THOMAS. I am trying to recollect. Over the last, I would say, 12 months in our membership, we have had a couple of cases like that. One in Nashville, Tenn., and one in Dallas, Tex. I hear rumors of many, but two that we could have substantive information on would be those two.

One job was just about complete, about $40,000 worth or more work to do on it. What finally wound up is we are now trying to negotiate a payment. In fact, we have negotiated a payment plan with the insurance company, that I do not want to mention right now, where it doubled. It became $80,000 when at the time before it was only $40,000.

By the time that the litigation and everything got on top of it, the minority contractor is now responsible for paying the surety company $80,000. And we have now come to a compromise of $60,000 to be paid out over the next 5 years.

Mr. MITCHELL. I am speculating, and I admit this. But I would speculate——

Mr. THOMAS. And it was close to a $1 million job. So I am saying, gee, he must have been worth it. It was 95 percent complete when this occurred.

Mr. MITCHELL. It is very troublesome. I am speculating, and I would just guess that a significant number of such contractors when they face that dilemma, No. 1, do not have the wherewithal to secure counsel. And certainly, they do not have the money to negotiate as you are doing in this one particular case in Nashville. And they just drop out of it.

Mr. **Thomas**. It just occurs to me, as you said, you have heard of six, and we have heard of two, that there should be some kind of benchmark in there when he becomes about 75 percent, or some figure. That you can intelligently say we are going to put a benchmark here, you know, at that time between the surety, the agent, the Small Business Administration.

Mr. **Mitchell**. Counsel.

Mr. **Gaegler**. Out of the million dollars that SBA paid in Colbert's case, $300,000 of that went to the surety's attorney and investigation. It is incomprehensible. Let me make one other observation, and then I will quit.

Mr. **Mitchell**. I have to interrupt you again for just a moment. Congressman Daub has joined us. I have cautioned that there is a matter in litigation, and we cannot get into that. We are trying to avoid any reference to his particular case, if we can.

Mr. **Gaegler**. In one case, without getting into any matters, as far as SBA is concerned, in all three cases, let me make an observation for you. In all three federally funded cases—and by that I mean Board of Education, Metro, or D.C. Government—all moneys came from the Federal Government.

That is why Colbert was sought out as a minority, because they had to use that kind of funding program. But in one case, the sorrow of this situation is that the general contractor has submitted to the Board of Education a voucher indicating that Colbert, and rightfully so, was 99 percent completed, under oath.

And despite the general owing him, Uncle Sam paid to the general $495,000 through the SBA program, even though the breach had occurred, even though Colbert was 99 percent finished, and even though it was submitted. Now that is sorry.

And then we end up in addition to that to Uncle Sam's attorneys fees in excess of $100,000 paid to the surety's attorney and investigator.

Mr. **Mitchell**. I am going to take the position that so often we are forced to take, and that is by throwing more work on staff. But I honestly think that we need to look at this problem. It is occurring with too much regularity. Not with reference to your case, but it must be an enormously frustrating experience to get 80 percent of the job completed, and then suddenly you are out.

Mr. **Gaegler**. Mr. Mitchell, just one more thing.

Mr. **Mitchell**. Just a moment. We will sort of see if we can structure a way to look at this, and deal with the half dozen cases that we have had. And we might have to solicit some additional information on that.

Yes, very briefly.

Mr. **Gaegler**. You cannot get any information from SBA. That is a fact of life.

Mr. **Mitchell**. All right.

Mr. **Gaegler**. Thank you, very much.

Mr. **Mitchell**. Let me say that your idea of $1.6 billion bonding going directly to contractors, I do not think is going anyplace.

Mr. **GAEGLER**. I know that, I am well aware of that. I think that it should be done. I think that bonding should be better.

Mr. **MITCHELL**. And I say that because this bonding goes to small concerns and minorities. But other witnesses have testified that there is a great deal of resentment developing towards the Federal efforts on behalf of minority businesses. I have heard that from the Administrator and others, that we have to be very cautious to try to save the programs, and not offend the majority community.

I think that if those are accurate statements, then I think that the idea of direct bonding to the contractor, particularly if it is minority, would just be dead.

Mr. Colbert, do you have a brief statement?

Mr. **COLBERT**. Yes, I do, sir.

I have had a lot of experience in construction and working. And going back to 1976, I was doing like $2.5 million through SBA programs. I know and I feel strongly that the program that Congress has put together, that the intent is there.

And I am 51 now, and I recognize the lust beyond just to destroy and tear down what you are trying to put together. There is no way possible that this program cannot be vital to a community.

There is only one thing that I feel is lacking in the SBA in their carrying out their job, and it is very simple. All you need, and the resources are throughout the Federal Government from GSA, all you need is arbitration. That would eliminate all of the nonsense, all of the validity of constantly elevating the job from $40,000 to $200,000 worth of vocabulary from attorneys. That is what it gets down to.

SBA does not have the capabilities or the people there with the knowledge. And these large private sector contractors and businesses out in the private sector know this. They do it so well, to the extent that they rehearse, and become experts in practicing it.

We had an experience with just one bonding company doing more business with SBA than any other surety bond company in the area. This bonding company had not been in business any longer since 1974. And this bonding company has done to the tune of $10 million in defaulting and breaching small and minority contractors.

And SBA sits there, and says we have no authority over this. But yet, they can pay out $10 million a month. Unfortunately, they cannot structure an arbitration team with the expertise in fields such us the mechanical, electrical, or architectural fields, and guarantee and structure the program that it will stop that type of nonsense.

That bonding company I mentioned earlier has structured itself so well that I have letters here where they can call people in key offices in certain areas throughout SBA on a first named basis, writing a letter and by oral correspondence, like my father did when I was overseas in combat. I can call you Joe or Henry, and that is good.

And I am very serious about this. I have a family to support. And with the help of God, I am going to do that. I feel strong just like Peter or Mark. And I never in my life have read the Bible so much as I have in the last 2 months, the Book of Acts.

There is going to be an end to this type of nonsense. There has got to come an end. The game plan may be set. However, internally, nobody can walk to the Government agent, and get drafts for $200,000 or $400,000, and no question being asked about it.

There has got to be an end sometime. Thank you.

[Mr. Colbert's prepared statement follows:]

PREPARED STATEMENT OF CHARLES COLBERT, PRESIDENT, COLBERT REFRIGERATION, INC., AND COLOK, INC.

I. HISTORY OF THE COMPLAINTS OF CHARLES COLBERT, COLBERT REFRIGERATION, INC. AND COLOK, INC.

We are of the opinion that Surety Bond Guarantee Program is being abused by Bonding Companies to the detriment of the small business person with or without the knowledge of the Small Business Administration ("SBA").

SBA participates with private surety companies through the guarantee program to reimburse the surety for up to 90 percent of its losses incurred while providing performance and payment bonds to minority and other small businesses.

The program is designed to assist persons who are small business concerns, who are required to post payment and performance bonds in order to bid on certain contracts, or to serve as prime or subcontractors thereon. Where such person is unable to obtain such bond on reasonable terms and conditions without the SBA's guarantee and where SBA determines that there is a reasonable expectation that such person will perform the covenants and conditions of the contract, SBA may commit itself to guarantee any surety against loss as a result of the breach of the terms of the bonds involved. Mr. Charles Colbert ("Charles"), principal of Colbert Refrigeration, Inc. ("Colbert") does mechancial, plumbing, heating, refrigeration and air conditioning work in the Baltimore-Washington area.

In 1973, Charles was accepted to meet the minority participation requirements of Irving Housing Construction, Inc., a general contractor which had obtained a HUD funded contract for the construction of Madison Park North, 900 West North Avenue, Baltimore, Maryland. Colbert's contract was in the amount of $550,000.00.

While performing this contract, Colbert was given financial assistance by SBA which guaranteed, what Charles thought to be, a line of credit with the McGlaughlin National Bank of Washington, DC ("McGlaughlin").

Colbert assigned its accounts receiveables to McGlaughlin and McGlaughlin drew two-party checks to Colbert's subcontractors, suppliers and materialmen. McGlaughlin also drew checks for Colbert's payroll. As Colbert performed the contract and requisitioned payments, the prime contractor's payment check went to the McGlaughlin Bank. Colbert would submit its payroll and invoices to McGlaughlin for payment along with the approved requisitions. SBA guaranteed that it would save McGlaughlin harmless should Colbert fail to pay the line of credit as due.

While performing the Madison Park Contract, Colbert entered into another contract to install some trash compactors for the District of Columbia under SBA supervision, and for the sum of $385,000.00. Again, SBA guaranteed Colbert's repayment to McGlaughlin and again the payment arrangement used for Madison Park was established.

Colbert, while successfully performing both contracts was notified by its creditors that their invoices were not being paid timely. Also, on numerous occasions, the pay checks given Colbert's employees were not honored due to stop orders being placed on them by McGlaughlin.

Charles visited McGlaughlin on numerous occasions complaining about the late payment of invoices and the failure to make the payroll as due. Although Charles became undesirable to McGlaughlin, he discovered that his company did not have a line of credit. Rather, McGlaughlin was honoring his payroll and invoices only when the requisition check was received and Colbert's funds were on deposit. When "Irving" or the D.C. Government were late in their payments (which was very often) McGlaughlin held the invoices and payroll or stopped payment on checks already sent.

Charles and SBA complained unceasingly to McGlaughlin about this practice when SBA was guaranteeing any loans or credit lines to Colbert only to have McGlaughlin withdraw from the agreement, leaving Colbert without working capital or credit. Colbert was unable to repay SBA for monies advanced these two contracts as working capital.

In addition to this tragic experience, it was finally discovered by SBA that the trash compactors ordered to be installed by Colbert were too large to fit into the designated areas of the buildings. SBA directed Colbert to modify the compactors at his cost, and to make them fit. Colbert was not given additional contract funds or change order payments for this additional work. Colbert's losses due to it completing its contract totalled $60,000.00. At this time Colbert was indebted to SBA in the amount of $200,000.00.

During the final phase of completing the Madison Park Contract, Colbert discovers, for a second time, that the mechanical equipment, chosen by the owner and approved by the owner's architects and engineers, would not fit into the spaces constructed in the newly erected buildings. The construction drawings were modified, the fronts of the buildings extended and Colbert was instructed to modify the installation at its cost. After completing the contract, Colbert attempted to obtain compensation for the additional work and materials used in the modification. Colbert's suppliers were instructed to deliver the necessary supplies and materials to the jobsite and were later paid a percentage of their bills; Colbert was oustered from the job. Here his losses amounted to $125,000.00. After a long legal battle, Colbert received $50,000.00 which was reduced by his attorney's fees.

In addition to the economic losses sustained under these two contracts, Colbert now is obtaining a certain unfavorable reputation in the construction community.

In 1974, Colbert entered into an agreement with the mechanical subcontractor as the minority participation, to do certain mechanical work for the prime contractor, General Construction, Inc., which had agreed with HUD to rehabilitate two high rise apartment buildings located at 14th and Fairmont Streets, Washington, D.C. Colbert's contract amount was $600,000.00.

After completing this contract, the attorneys for Colbert were able to force a settlement with the prime contractor and Colbert was paid most of the contract price.

In 1975, Colbert obtained a $178,000.00 contract to do certain mechanical work on the D–14, New Carrollton Metro Station in Washington, D.C. This contract was fully performed and fully paid.

During 1976, Colbert performed a $236,000.00 contract doing the mechanical portion of the rehabilitation of the Williston Housing Project for the District of Columbia. Colbert's work has been accepted, but Colbert is still pursuing various legal and political avenues, attempting to obtain his contract balance.

Colbert was contacted by a mechanical contractor which asked that they both bid on certain segments of the District of Columbia Metro line. Colbert was offered a part of the mechanical contract at the G–3 Metro Addison Road Station at and for the sum of $556,885.00. Charles applied to SBA for a loan to be used as working capital along with fidelity bonding. He was rejected by SBA because Colbert owed SBA $200,000.00. Colbert attempted to negotiate an arrangement with SBA repaying SBA from the profits it would earn in the performance of future contracts. Colbert argued that it was a viable contractor with numerous contract offers which, when performed, would allow Colbert to pay off its indebtedness. Help was refused.

Colbert was introduced to Dependable Insurance Co., Inc. ("Dependable") by a mechanical contractor. Dependable assisted Colbert in obtaining the surety bond and other assistance required, and Colbert was awarded the contract in the name of Colok, Inc., on March 16, 1976. The prime contractor was Granite Construction Company and S. J. Graves and Sons, a joint venture ("Granite-Graves").

Early in 1976, M-Cap, a minority association in the District of Columbia gave Colbert's name to the James B. Galloway Construction Co., Inc. ("Galloway") which was seeking minority participation in its bid for the D.C. Government—Langdon Park East Recreation Center Contract being offered by the District of Columbia.

Again, Colbert sought an SBA loan and was rejected. Colbert explained its financial problems to Galloway and stated that it could do the job in a workmanlike fashion, but it would have to be paid timely as it was without startup funds. Colbert and Galloway agreed that Colbert would perform the plumbing, heating, ventilation and insulation work for $225,000.00. Galloway was to make Colbert's payroll and pay Colbert's subcontractors, suppliers and materialmen with two-party checks until Galloway could develop a work, pay and performance experience with Colbert. Then Colbert's monthly requisitions would be honored. Surety bonding for payment and performance was provided by Dependable and guaranteed by SBA.

While performing the G–3 Addison Road Station and Langdon Park East Recreation Contracts, Colbert was contacted by the Minority Contractors Association of Maryland, located in Annapolis and informed that a New York contractor was seeking minority participation in the construction of the LaPlata High School in Charles County, Maryland, and that Colbert was the only minority listed capable of handling a mechanical contract of the magnitude contemplated. Colbert met with the principals of Iorio Construction Co., Inc., who were seeking the school construction contract. Colbert agreed on September 16, 1976 to perform all mechanical, heating, ventilating, air conditioning, and plumbing work under the construction contract for $850,000.00.

Colbert's subcontract was submitted to SBA for financial and surety bonding assistance. Again, SBA refused financial assistance. Dependable agreed to arrange such financial assistance as Colbert would need. SBA guaranteed Dependable's bond.

II. ANALYSIS OF THE COMPLAINTS OF CHARLES COLBERT, COLBERT REFRIGERATION, INC. AND COLOK, INC.

We feel that the handling of three contracts G-3, Addison Road Station, Langdon Park East Recreation Center and La Plata High School by Dependable and SBA are indicative of how the Surety Bond Guarantee Program is being used by the prime Contractor and surety for their own economic interest and benefit at the expense of SBA and the small business concern.

On all three of our jobs and many others of which we are aware, the small business concern is placed on the job and allowed to work. During the progress of the work, notices of irregularities, delays and defects, inherent in all new construction are continuously sent to the small business concern. Then the periodic payments, essential for vitality and the sole source of working capital, are diminished, delayed and stopped. The surety, in its benevolence, comes to the aid of the small business concern and pays or directs the prime contractor to pay the employers and workers along with some suppliers and material-men in order to get the major portion of the work completed by the small business concern. When the work is down to adjustments, checks, tests and balancing, a default is charged by the prime contractor against the small business concern. The surety is notified that if it does not take over and perform, a total breach of contract will be declared. The prime contractor is still accepting the work, submitting it to the owner, being paid, retaining percentages, and in the final phase holding the contract amount.

The small business concern is dismissed, a takeover contractor is brought in, the surety's principals, usually attorneys start sending bills; the surety's consultants, usually its own employees with minimal professional qualifications and knowledge, investigate the alleged default, and the contract is completed at two to three times the price the small business concern would have completed it for.

Finally, under its agreement with its surety, SBA without any notice of pending or actual default, attempts to remedy or prevent default or investigation as to the existence of a default, pays the surety 90 percent of the claims presented. No supporting documents, voucher, contracts, time sheets or requisitions are given SBA or the small business concern.

In many instances, the prime contractor never surrenders the balance of the contract price and additional funds it receives for change orders and delay claims.

SBA's position is that the mere submitting of a claim and demand for payment by the surety, is prima facie evidence that the small business concern's interest has been protected, that it has been assisted in its attempts to correct the situation and that the surety has mitigated and minimized damages.

This sequence of events is fostered and promoted because the prime contractor meets its obligation for minority participation and reaps a handsome bonus. The surety helps small business concerns, does business and makes a profit.

The small business concern is the only entity involved in this arrangement which does not benefit from the SBA program.

Charles, Colbert, and Colok, were introduced to this scenario by the Dependable Insurance Company which provided the payment and performance bonds on three construction subcontracts.

On the first, dated March 16, 1976, for certain work in the construction of Section G-3 Addition Route, Addison Road Station, of the Washington Metropolitan Area Transit Authority in the amount of $556,885.00. Work began in May of 1976 and Colok notified by Dependable and Granite-Graves in December, 1978 that it was in breach of contract and that Dependable would obtain a takeover contractor to complete the job.

The default which Dependable states its independent investigator Surety Consultants, Inc., confirmed, is that Colok delayed the completion of the prime contract, failed to pay its subcontractors, suppliers and materialmen, failed to man the job with sufficient personnel and did not have adequate personal finances to complete the job.

Dependable was notified by Colok, that Colok was prepared to declare that Granite-Graves had breached the contract in that Granite-Graves was accepting Colok's work submitting it to the owner, WMATA, getting paid, but not paying Colok in accordance with their contract.

The contract between Colok and Granite-Graves requires Granite-Graves to pay Colok within ten (10) days after the date Granite-Graves receives payment from WMATA.

Because of Granite-Graves breach of the payments clause in the contract, Colok, a small business concern, was unable to pay its subcontractors, suppliers, materialmen and employees. Granite-Graves' explanation to Colok and its other subcontractors was that it could not pay them as it had not been paid by the owner WMATA. This was not so. Dependable was informed of this failure and breach by Granite-Graves but instructed Colok to continue working while an investigation and reconciliation was achieved. After being unable to get Granite-Graves to pay Colok, Dependable told Colok to continue to work and it would make Colok's payroll. Colok acknowledges that it owes Dependable for monies advanced for payroll.

Granite-Graves was advised by Colok before work began that there were very serious irregularities, defects and illegalities in the plans, drawings and specifications. Granite-Graves took three (3) to four (4) months responding and giving directions to proceed. Numerous delays occurred as Colok tried to get a completion schedule, coordinate with other trades, solve problems in the field and cope with delays occasioned by WMATA and Granite-Graves.

When the entire contract fell behind the owner's progress schedule, the owner notified Granite-Graves that if the work was not accelerated to meet the planned completion schedule, the liquidated damages clause of the prime contract would be involved. Granite-Graves immediately sent a similar warning to its subcontractors.

Dependable knew of this and was called in by Colok to make an on-site inspection to assure that Colok was not the cause of the delay. However, after Dependable's representative and his wife flew to California as the guest of Granite-Graves, Granite-Graves sent Colok a letter declaring that Colok was in default for delays, shoddy work, insufficient manpower and failure to pay its obligations. Dependable concurred, and Colok was oustered.

Dependable then attempted to complete the contract with takeover personnel and contractors. It received the same letters from Granite-Graves alleging delay, failure to meet schedules, shoddy work, etc.

At the time of its ouster, Colok was 98 percent complete and had been paid $373,885.00 with $183,000.00 remaining without the numerous change orders. Dependable alleges it spent $300,000.00 plus in completing the contract and was reimbursed by SBA $266,982.98, $83,982.98 more than Colok would have been paid if allowed to remain on the job and complete it. It is to be noted that the majority of the remaining monies due Colok is its profit.

It is to be noted that the legal fees for Dependable's principal and Dependable's consultant amount to almost $83,000.00. Both are employees of Dependable.

Granite-Graves held the contract balance as Dependable made no effort to submit requisitions for the work done and accepted during its close-out of the contract.

Upon final acceptance of the work, WMATA admitted that there had been numerous and serious delays not caused by Granite-Graves or Colbert and paid Granite-Graves an additional sum on its delay claim. The claim filed by Granite-Graves with WMATA contained the very items we allege prove that Colbert had not delayed the progress of the work, but that the delay was due mainly to faulty drawings and WMATA's delays.

On August 4, 1976, Colbert commenced certain mechanical work on the Langdon Park East Recreation Center for the sum of $225,000.00. Dependable issued Bond No. 1213. Colbert worked from October 12, 1976 until November 1, 1978. Again, when Colbert had completed 90 percent of the work and had been paid $144,588.02 with a balance of $80,411.98, he was found to be in default.

Dependable took over the job and alleged that it completed the contract. It then was paid $46,954.61 by SBA for its losses. Dependable actually advanced $39,227.60. It is believed by Colbert that Galloway still holds the contract balance of $80,000.00.

On September 16, 1976, Colbert began certain mechanical work on the LaPlata High School in La Plata, Maryland for the sum of $850,000.00. Dependable issued Bond No. 1214. Colbert worked from November 30, 1976 until May 3, 1978 when Iorio had the Charles County Sheriff to order Colbert and its employees off of the job site without allowing them any time to collect their tools and equipment.

Dependable has been advised and participated in all matters leading up to this breach by Iorio.

Upon Colbert's ouster, Dependable agreed to pay Iorio to complete the job. Dependable paid Iorio the sum of $550,000.00. However, Iorio did not complete the job but instead abandoned it.

The School Board had the entire construction, including Iorio's work, completed upon Iorio's breach for approximately $308,000.00.

Dependable was reimbursed $443,275.90 by SBA.

Colbert had been paid $550,495.30 with a balance of $299,504.70 due it.

Surely, Dependable would not have spent its own money this freely and without safeguards, only with SBA's guarantee.

Now, Dependable is pursuing Colok, Colbert, Mr. and Mrs. Colbert as indemnitors and others to collect the sums it alleges it spent to satisfy its obligations under the three bonds herein, and collecting attorney and investigation fees now from SBA.

Colok and Colbert have been unable to remain in business because of these disputes. Numerous opportunities have been offered Colbert, but it has been unable to accept work because of Dependable's claims on behalf of SBA.

There is no possible interpretation of the Small Business Investment Act that will justify it being abused to the degree we find herein.

III. STATUTORY AND REGULATORY PROBLEMS PRESENTED COLBERT BY SBA

The Small Business Investment Act of 1958, Subchapter IV-A, Part B—titled "Surety Bond Guarantees" has as its purpose the strengthening of the competitive free enterprise system by assisting qualified small business concerns in obtaining bid, payment, or performance bonds which are otherwise unobtainable without an SBA guarantee. (13 CFR 115.2)

Consequently, Congress has authorized SBA to guarantee sureties participating in the Surety Bond Guarantee Program up to 90 percent of the losses incurred as a result of a principal's breach of the terms of bonds which are ancillary and coterminous with such bonds. "Loss" means all damages, court costs, counsel fees, charges, and expenses which the surety has incurred and actually paid as a result of having executed bonds guaranteed by SBA, less the amounts recovered at the time of payment by the surety company. (13 CFR 115.3)

Application for an SBA guarantee is made by the principal to a surety on the SBA Application for Surety Bond Assistance (Form 994) and the Schedule of Contractor's Uncompleted Work (Form 994 for equivalent).

A guarantee agreement is entered into between SBA and the surety which shall contain, among other conditions, that the surety will take all steps necessary to mitigate any loss resulting from the principal's default, and that the surety shall inform SBA of any suit or claim filed against surety on any bond. (Part II, SBA Form 990 and 13 CFR 115.6)

SBA at its sole discretion may refuse to issue further guarantees to a participating surety where the administration finds that the surety, in its efforts to minimize loss, or in its claims practices, has failed to adhere to prudent underwriting standards or other practices. Acts of wrongdoing such as fraud or material misrepresentation shall constitute adequate grounds for refusal to issue further guarantees. SBA may also impose other sanctions against a surety which experiences excessive losses on SBA-guaranteed bonds resulting from unacceptable underwriting and/or claims practices, relative to those of other sureties participating in the program. (13 CFR 115.13)

At all reasonable times, SBA may audit in the office of either a participating surety, its attorneys, or the Contractor, all documents, files, books, records and other material relevant to the Administration's surety bond guarantee. The Administration may conduct such investigations as it deems necessary to determine whether a person has engaged or is about to engage in any acts or practices which constitute or will constitute a violation of the Small Business Investment Act of 1958, as amended, or any rule or regulation this Act or of any order issued under this Act.

SBA has adopted certain Standard Operating Procedures for the administering of the Surety Bond Guarantee Program. Chapter 8 of Section 50 No. 45 of the SOP details instructions for the processing of claims filed under this program.

Paragraph 31 of Chapter 8 states that the sole authority and responsibility for handling claims arising by virtue of a contractor's default on a bond guaranteed by the SBA shall remain with the Central Office, Surety Bond Guarantee Program's personnel. When a field office is notified by a surety of an impending contractor's default, the regional CED personnel are to immediately forward a copy of the referenced case file to the Surety Bond Guarantee (SBG) personnel in the Central Office. The regional CED personnel are to keep the Central Office SBG personnel fully apprised of developments pertaining to the defaulted or defaulting contractor. Notification of pending defaults is for the purpose of providing the Central Office staff with sufficient time in which to work out an arrangement which will salvage the job from default.

Once a surety has notified the SBA of a default, and the Central Office SBG staff has received the appropriate case file from the regional office, the SBG staff will review the case and take whatever action is necessary to protect the Small Business Administration's interest.

The objective will be to prevent a formal contract default, if that is possible. If the default has already occurred, SBA will strive to minimize the loss incurred by the surety and SBA.

If at all possible, SBA will assist the defaulting contractor in his attempts to correct the situation and remain as a viable, small contractor. These latter efforts will require coordination and negotiation with the contractor, surety, obligee, other governmental agencies, financial institutions, and various SBA personnel, i.e., 8(a), 7(a) (including revolving line of credit), ME, PMA, LAD, 406 and SCORE, etc.

The Central Office SBG personnel will review the defaulted contractor's case file and extract such data as is available to document the status of the default.

The Central Office is the only office authorized to reimburse sureties for losses.

We are of the opinion that the Surety Bond Guarantee Program as it is now designed by 15 U.S.C. Sections 694a and b, is vital to the small business concern seeking construction and other work.

The regulations adopted by SBA as its Standard Operating Procedures, if complied with, would effectively administer this program to the benefit of both the small business concern and SBA.

The failure appears to be in the position taken by SBA administrators that they are working only with and for the surety, and therefore have no obligation to or relationship with the small business concern.

Mr. Mitchell. Mr. Colbert, a member of the staff is going to want to consult with you privately for just a moment.

Thank you, very much, gentlemen.

Mr. Gaegler. Thank you, very much, sir.

Mr. Mitchell. Thank you.

Our next witness is Mr. Sanders, the Administrator of the Small Business Administration. Thank you, Mr. Administrator, for being here with us this morning. As we look at the Surety Bond Guarantee Program, you know what we have done in terms of our proposed level of funding. And we would be delighted to hear your statement about how the program is being administrated.

TESTIMONY OF JAMES C. SANDERS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION; ACCOMPANIED BY EDWIN HOLLOWAY, ASSOCIATE ADMINISTRATOR, OFFICE OF FINANCE AND INVESTMENT

Mr. Sanders. Thank you, Mr. Chairman.

Accompanying me at the witness table is Ed Holloway, the Associate Administrator in charge of our Office of Finance and Investment, which includes bonding. I will dispense with reading my printed statement, and I am sure that you are glad to hear that.

As you know, in our statement, we have listed a number of steps which we have taken in the past year to improve and strengthen this particular bonding program, which is obviously not without its faults, and a program in which the people from the staff themselves perceived a number of areas for improvement.

I would like to make a few comments about the statements of some of the witnesses, and I have enjoyed very much listening to them, Mr. Chairman. It has been very instructive. And I particularly think that some of the suggestions by the first three gentlemen who appeared here were interesting, constructive, and will certainly receive cooperation from me and our staff.

Mr. Meushaw, Mr. Thomas, and Mr. Magnotti, I think, demonstrated a level of understanding of the program that can contribute to solving some of the problems.

You know, I come to this particular meeting with a little bit of added relish, because I was a civil engineer, and worked in construction, and I was later in the bonding business. So it is of great interest to me to deal with some of the problems, and see some of the opportunities.

I believe in this program, Mr. Chairman. But I think we have to see that this program gains in its support for all kinds of small business people, and minority contractors in particular. We have to distinguish what a bonding program can do, and what it cannot do.

You cannot solve some of these kinds of problems that Mr. Colbert alleges that he ran into, and some of the injustices that he alleges were done to him. I have no judgment on that, but I do know that in that particular case, we had the Inspector General go into the adjustment of that particular loss with Colbert and the bonding company that bonded him, and we found no provable irregularities. That was the result of the Inspector General's investigation.

We certainly, in this program, are anxious to pick up on any kind of evidence that some of these bonding companies are deceiving us, misrepresenting some of the facts, taking advantage of any of their principals, the contractors. And if we can move in that direction, we will do so with great speed.

We did, as you know, revise our regulations last year, so that we could pick up on the integrity issue, and get rid of some bonding companies in that relationship.

Mr. MITCHELL. Let me interrupt you for just a moment. We are dealing with bonding companies right now. But the problem that I alluded to of firms being dropped, subs being dropped out, after jobs are 80 percent complete and so forth, might not necessarily have been instigated by the bonding company. It could be the prime.

Mr. SANDERS. Oh, certainly.

Mr. MITCHELL. So I do not want to cast a general aspersion against bonding companies.

Mr. SANDERS. Mr. Chairman, that is where it would have to be. If the prime contractor or the owner can claim a default, then it starts from that action. Then the bonding company is put on notice, as is the contractor.

To move from that point to the proposition that the SBA should be involved as a party to all of this all along, would put us in such a caretaker position, that it would far exceed anything contemplated in the bonding program.

We have provided a guarantee for private companies to enter into a bonding operation, so that small and minority contractors would be bonded. But we are not the bonding company.

We do hope that we can increase the number of companies that are involved in the program. We are taking steps in that direction. We are trying to expand the kinds of contracts under which we deal with bonding companies to include what in the industry is known as a treaty reinsurance agreement. That would be the ultimate.

With this agreement our people do not have to reunderwrite, and make a judgment on each case, each contract. Also we deal on a year-to-year basis with the major bonding companies. The major bonding companies that have not been participants in this program to a major extent, are interested in this approach. And we are working on that.

We are also working on a kind of facultative treaty, which is a kind of in-between measure. This treaty may produce some results and would also, increase the interest in this program.

You know, the bonding relationship is an important part of the development of a contractor, just as is his banking relationship. A contractor who begins in a very limited way starts out with small jobs, because he is limited by both capital and experience. Maybe a little more of one than the other.

As he grows and accumulates earnings and working capital, he gets a larger and larger capacity to do work. If he goes along with his bank and bonding company, they recognize his development, and they keep increasing the limits for which he can be bonded.

The worse thing that you could do for a beginning contractor is to bond him for a job for which he has no capability financially or management-wise to complete, and he goes under. That is why this development of a bonding relationship is very important.

I certainly agree with the comments that some of the others have made here earlier about having all of the SBA programs dovetail, such as the 7(j) contracts. We would like to do that to the extent that we can. Of course, we cannot have a 7(j) contract for every contractor that gets a job in the United States who would be a minority. That would be an incredible increase, as you well know. And I know that you do not expect that.

We talked about the marketing possibilities; increasing the awareness in marketing. I am fully supportive of cooperating with Mr. Thomas' association and Mr. Magnotti's association, too, for that matter.

And I think that you correctly put your finger on it. A large part of that marketing should be done by those who are making a profit in the whole operation—to those for whom it is an interesting proposition. That is the contractor who makes a profit, and the bonding company which hopefully is making a profit, also.

Outreach and meetings. We are trying to increase our activity with our banks, and have scheduled meetings with them. This process has been on-going for some time. We are anxious always to meet with the bonding companies.

There was a statement made, I think, by one of Mr. Colbert's attorneys that he seemed to be under the impression that the SBA is designed to help the surety, not the contractor. Certainly, that is not the intent of this administration. The intent is to make it an interesting proposition for both the contractor and the surety. The sureties, if there was not something in it for them, would not get into the program. I think that we all accept that. But a good deal is a good deal for both sides.

I have not the slightest idea what the gentleman meant by turning the guarantee back to the contractor instead of the bonding company. I am very confused by that. That is not a bonding operation at all. That is some kind of first party insurance agreement.

Mr. **Mitchell.** I think that you will recall that I indicated that just is not going to fly.

Mr. **Sanders.** No, that is just not bonding. You referred to the fact that you have some information on 8 or 10 other companies.

Mr. **Mitchell.** Six.

Mr. **Sanders.** Six companies that you are told that have gotten to a sizable portion of completion of the contracts, and then dumped. There are, of course, in so many contractual arrangements those who would take advantage of subcontractors.

I think that one of the greatest problems for subcontractors has always been that the prime contractor works on their money too long, and the retentions are far too large. But that is not something that we can solve through the SBA guaranteed bonding operation. That is not within our province. And as a matter of fact, I do not think that the bonding companies can solve that. It is a matter of a tort that they can bring redress into court. And I suppose that that is where Mr. Colbert's redress is.

Anyway, these are the few comments that I would like to make, Mr. Chairman. Whenever we hear of an irregularity in connection with a company that we do business with, we like to go to the root of it, and get the evidence. And it has been, as you know, in the history of this program, that there have been some companies that have taken advantage of the SBA and the Federal Government. I would like to root those companies out of our program.

Thank you.

[Mr. Sanders' prepared statement follows:]

Prepared Statement of James C. Sanders, Administrator, Small Business Administration

Mr. Chairman and members of this subcommittee: I am pleased to discuss today the Small Business Administration's (SBA) Surety Bond Guarantee (SBG) program.

The program began in December, 1971, when Congress provided through Public Law 91-609 the authorization for small and minority businessmen to obtain a bond from surety companies which would be guaranteed by the SBA. The legislation was designed to enable these businessmen to compete for construction and other contracts that they are able to perform.

Since the program's inception there have been over 300,000 guarantees approved resulting in over 150,000 contracts amounting to $12 billion. Out of this total roughly 24,000 contracts have been made to minority firms for almost $2 billion. The Surety Bond program is currently the second largest guarantee program by dollar volume at the Agency.

SURETY BOND PROGRAM

By way of explanation, let me outline how a surety bond transaction occurs. Let it be understood from the beginning that SBA does not directly bond a contractor.

Surety bonding is often a prerequisite for the award of both Government and private contracts especially in construction work. The Miller Act requires surety bonds on all Federal construction contracts of $25,000 or more. When bonding is required, the contractor might have to obtain three types of bonds: bid bonds, payment bonds, and performance bonds.[1]

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[1] A bid bond is presented with a bid on a proposed contract. It is a joint guarantee by the bidder and surety company to the owner that, if such bid is accepted by the owner, the bidder will provide performance and payment bonds and enter into a contract with the owner to perform the job according to the owner's specifications for the sum of the bid amount.

Continued

These small businesses in many instances would never have this first opportunity without SBA's guarantee. The small firm typically does not have large amounts of capital or a long satisfactory history of bonding. The small business firm learns of a contract and knows that he must be bonded. He then contacts his insurance or bonding agent and applies for a bond by providing background, credit and financial information required by the surety company. SBA is then approached by the surety and if certain conditions are met the Agency agrees to guarantee the bond.

The Agency has four requirements. The firm must qualify as a small business. The owners must possess good character and reputation. There must be certification that a bond is required and that the bond is not obtainable on reasonable terms and conditions without SBA's bond guarantee assistance.

If the bond is approved the SBA agrees to guarantee 90 percent of losses incurred on contracts whose face value is under $250,000, and 80 percent on contracts between $250,000 to $1,000,000. No guarantee will be granted if the contract exceeds $1,000,000. The contract amount of $1,000,000 is set by statute and the percentage of guarantee by SBA has been established by regulation. In return for the guarantee the surety pays to SBA 20 percent of the bond premium.

A fee of 0.5 percent of a contract's face value is paid by the contractor to SBA if that contractor is the low bidder and the bonds are guaranteed by SBA.

In the event of default by the contractor, the surety company is obligated to satisfy the bond either by completing the contract or paying the penal sum of the bond. The SBA Guarantee Agreement specifies that the surety shall take charge of all claims matters arising under the bonds; determine its liability; compromise, settle, or defend any claim or suit; and take such action as it deems necessary to minimize loss. The surety has the right to recover any losses it sustains from the contractor. In addition, SBA must reimburse the surety for 80 to 90 percent of its unrecovered losses.

STANDARD AND SPECIALTY SURETIES

When the Surety Bond Guarantee program was established it was decided that a minimal staff was to operate the program, because it was expected the surety industry would apply its standards in underwriting and the payment of claims of bonds guaranteed by SBA. The decision was made to rely on Treasury Circular 570, which lists acceptable sureties.

It was anticipated that the standard surety companies would participate in the program. As the program developed, it turned out that many of the standard sureties did not participate.

A new type of surety then emerged, to fill the void—the specialty surety. Ninety-seven percent of the surety bonds guaranteed by SBA are done with specialty sureties. Approximately 10 or 15 standard sureties account for the remaining three percent of the bonding.

Specialty companies are generally smaller, are more restrictive in their coverage, and are not as financially strong as standard carriers.

The specialty companies came into existence because they were willing to bond contractors that the standard sureties would not consider, and because SBA would guarantee the bond. The standard carrier is usually larger, and more financially secure, and it will only bond firms that are financially sound and have completed many projects.

The specialty surety filled a need but also brought problems to the program that are often found in new enterprises. Several Congressional hearings have been held resulting in an intensive analysis of the total activity of the program.

STRENGTHENING SBG PROGRAM

To overcome some of the difficulties that were brought to light, program officials strengthened management control and implemented review procedures.

Semi-annual training meetings have been established. Field Surety Bond officers are being rotated into the Central Office for additional training. Plans are to bring

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A performance bond is a guarantee jointly by the contractor and a surety company to the owner that the contractor will satisfactorily perform the contract in accordance with plans, specifications, and all contract documents.

A payment bond is a joint guarantee by the contractor and a surety company to the owner that the contractor will pay promptly the wages of all workmen employed by the contractor on the job; the invoices for all materials used by the contractor on the job; the invoices for all subcontractors; and all other direct job costs.

in second level assistants in the near future to provide them with comprehensive knowledge of the program.

Other measures that have been taken to strengthen the surety bond program are the following:

1. In February, 1983 a final business integrity regulation was published.
2. An underwriting handbook has been cleared for use. A claims handbook has been developed and is in use in the Central Office. It will be revised and given industry distribution when new regulations are issued.
3. On-site visits to participating sureties are being accomplished on a timely basis.
4. Centralization of Region III and Region IV surety operation has been accomplished. These actions will enable management to provide better and more efficient control of the program.
5. A revision of SBA's automatic data processing system for surety bond guarantees is in process.
6. An RFP for revision of the SBG claims process is being written. This will provide for an overview of the claims process.
7. The financial guidelines have been recently revised which will allow greater flexibility in their application to the individual case.

SURFACE TRANSPORTATION ACT

The 10 percent set-aside provided in the Surface Transportation Act should be of great value to minority owned businesses. We are presently negotiating a Memorandum of Understanding with the Department of Transportation which will assist DOT grantees with the identification of capable, eligible minorities. The Act requires that eligible concerns are those which are socially and economically disadvantaged as defined by the Small Business Act.

In the next four fiscal years nearly $5 billion is projected to be awarded under the Surface Transportation Act for the set-aside. In Fiscal Year 1983 alone, $998 million will be available to minority businesses.

PROGRAM RESULTS

There are many positive aspects to the SBG program, and I would like to share these with you. Since the beginning of the program in 1971 through February 1983, there has been a net savings to the government of over $250 million due to contract awards to surety bond guaranteed-contractors. SBG applications received totalled over 318,000 since 1971; SBG applications approved numbered over 300,000 while the number of contracts awarded to approved applications was more than 150,000 with a total value of $12 billion.

The dollar losses represent only 1.8 percent of the contracts awarded. This compares favorably with the surety industry loss rate.

CONCLUSION

SBA's assistance through the Surety Bond Program has provided a genuine service to small contractors because it allows them to develop their business to a point where bonds can be secured without SBA's guarantees. The Agency has through many efforts strengthened the program and has attempted to make the bonding process easier, encouraging small and minority businesses to participate.

Mr. Chairman, this concludes my prepared remarks and I would be pleased to respond to your questions.

Mr. MITCHELL. Thank you, very much. I only have a few questions.

In your statement to us, you talked about the desire to coordinate the bonding program with the guaranteed loan program, and the 7(j) program, recognizing the limitations that can be imposed on that kind of coordination.

But could you be more specific, and tell me what, if anything, you are doing right now to link all three of these facets together for the surety and the guaranteed loan program, or the surety bond guarantee and the 7(j) program?

Mr. SANDERS. Most of what we are doing, Mr. Chairman, is throughout internal communications. We are trying to make everyone aware in the SBA that each employee of the SBA is an advocate for all of our programs. And we are trying to increase the cross information and the cross education of all of our employees alerting them to all of the other programs that we have that can work together.

And in particular, we have been experimenting in several regions by using the management assistance people for what we call a one-stop information center. So when somebody comes in, has a problem, wants to work a bonding situation, wants to know where to go, this person will tell them of all of the other possibilities that they might avail themselves of with our SBA programs.

Mr. MITCHELL. Let me get at it a little more sharply. Suppose you have a firm that has gotten to the point where it is just about ready to receive a guaranteed loan. You have gone through the entire process. Would the bank know, for example, that before they finalize that loan, that that company also has a guaranteed bond?

Mr. SANDERS. I would hope so.

Mr. MITCHELL. That would be standard operating procedure that they would?

Mr. SANDERS. I think that we have disseminated the information to the banks. And we are aware that there are too many banks that do not realize all of the facilities at SBA. And I am afraid that there are a great many more that do not care about all of the facilities of the SBA. They have their own facilities of the bank to worry about.

But insofar as it is possible to use banks as a font for information on the SBA programs; yes, we will. But there is a great lack of uniformity, as I am sure you are aware of this program with all of the banks that we deal with across the country.

Some do a good job for the SBA by being aware of all of the programs, and others do not. The best that we can do is to give them the information.

Mr. MITCHELL. Well, it would certainly seem to me to be helpful if a bank knew that before it made that loan that this guy has a bond on the performance of the job that gives him an added credibility, it seems to me.

Mr. SANDERS. Mr. Chairman, if he is going to get a loan to perform a contract, I cannot imagine that that banker is going to give him the loan until he knows that he has got a bond.

Mr. MITCHELL. But you are saying that the banker would have to pursue this, that this would not be a part of the SBA operation.

Mr. SANDERS. Well, it can start at the bank, you see. The fellow can walk into the bank, and say I would like to get a loan. And the banker would say, well, you qualify for a SBA loan, and we would be interested in it if SBA will guarantee it. How long will this job run, et cetera, et cetera, and do you have a bond.

And the fellow says no, I do not have a bond. And then he would refer him to a bonding agent. Then I would hope that the bonding agent would say well, I think that you should get a SBA guaranteed bond, because you have never had one before.

Mr. MITCHELL. There are two other questions that I have. Two witnesses referred to, and I am using a direct quote from them, "rampant and inconsistent changes in policy and policy interpretation with regard to the surety bond program."

I think that Mr. Magnotti indicated an instance when it was proposed that there might be a policy change in the surety bond program. And then that idea was somehow misinterpreted by field offices, was it, or local offices, that the policy change indeed had gone into effect.

Is that a problem? These witnesses have said without any equivocation that that causes a great deal of problems in the field.

Is that a problem from your point of view?

Mr. SANDERS. Well, there are two ways to answer that, Mr. Chairman. First of all, I would like to know the specifics of the one that he is speaking about. There have been, as you know, and we discussed it here, I believe, last year, the guidelines that we have published for bonding underwriters; not standards, but guidelines.

We tried to clarify that situation nationally. And I think we have. But there is always the problem when you are dealing with an organization like the SBA that has almost 100 offices across the country maintaining uniformity of understanding and delivery. And that is true of any organization with that many outlets.

And, of course, as you know, in the Southeast area, we are placing the responsiblility at regional operations for the bonding, for the issuing of the bonds, for the approvals. Previously, in the Southeast, we had all of the district offices which had some authority. And I imagine that there was a little variety one to the other.

So we are trying to get some uniformity in the situation, and we would be pleased to hear from Mr. Magnotti or anyone else that has evidence that somebody is giving a contrary signal—contrary to our stated policy.

Mr. MITCHELL. Well, I think that you heard that this morning.

Mr. SANDERS. I would like the specifics, though.

Mr. MITCHELL. You want the specifics. I am sure they will share that with you.

Again, the witnesses testified about the absence of information to the small businesses concerning the Surety Bond Guarantee Program. You, yourself, indicated that maybe you are not reaching enough people, I think that you said that, to get the information out.

Mr. SANDERS. I said that we are concerned that that is an ongoing problem—communication and information. But I also said that we would be pleased to see these organizations, the National Association of Minority Contractors and the American Specialty Surety Council, take some constructive steps in information and marketing, the whole program.

Mr. MITCHELL. The last question from me is that just a moment ago, you stated that the Small Business Administration should not be involved once the surety bond has been issued. It is working with the bonding company. And yet, I think in the SBA regulations, it states that the SBA will indeed in fact work with a firm's surety to prevent a formal contract default.

Mr. SANDERS. Will work with?

Mr. MITCHELL. Will work with a firm's surety, its surety company to try to prevent a default.

Is that not a part of your regulations?

Mr. **Sanders**. Well, I did not mean to imply that we would not work with the surety to prevent a default. What I was commenting on an idea floated out here a few minutes ago that the SBA should be actively involved in each contract as the contractor either falls toward a default situation, or begins to increase his gain on his payments. Tracking each contractor on the contract, and being responsible to see that he does not default and fall through.

That, of course, is far beyond our capability. And not even a surety company will perform that kind of nursemaid treatment.

Mr. **Mitchell**. This is in the regulations.

How exactly do you handle that situation? Would a firm come in to you, and say, look, I am bonded through the surety bond guarantee program, and I am working with this prime, and here are my records to show that I am 80 percent complete. I did not complete the job, and I am behind 2 months on the job because the Federal agency failed to pay me in a prompt fashion, or something like that.

Then what do you do; would you act on a case that comes directly to you?

Mr. **Sanders**. Well, I would hope the contractor would come to us early enough and say I have a bond through your bonding program, and I am concerned about defaulting because of my own record. I am also concerned about the taxpayers losing something, and I think that I have been taken advantage of, and I would like some help. And, hopefully, our office will respond by coming in with a management assistance type person, and say well, let us see what the problem is. And the fellow says tomorrow they are going to pick up my equipment. We will say, gosh, we wish you had told us a week ago. We will get help there, and see what we can do. We think that you better hire an attorney first.

I certainly agree with Mr. Colbert's attorneys opinion that attorneys get too much money out of these things. But nonetheless, that is the way that the game is played. He probably is going to have to take some estoppel action.

Mr. **Mitchell**. I wish that I could feel more comfortable, but I am not.

Mr. **Sanders**. Well, what would you expect us to do, Mr. Chairman? Let me put it that way.

Mr. **Mitchell**. If I could just proceed for a minute, and explain why I feel uncomfortable. A moment ago, you suggested tort action to remedy this situation. And earlier on during the course of the hearing, it was indicated that there are many small firms that reach that point where they just cannot get a lawyer. They just do not have the money for it.

That is one of the reasons that I would be uncomfortable. And I would hope that you could play a larger role. And second, just a moment ago, you indicated that this firm might get to you, and say tomorrow my equipment is going to be taken away from me.

The fact of the matter is that in many cases, that notice of default is hit so fast, that the guy really does not have time to come to you. Nobody knows that the default is coming, or at least in the cases that I have dealt with. It has been a very, very quick action.

And the guy says, look, you have not said anything, I am 80 percent complete. And you have been telling me I have been doing a good job. You told me last Monday that I am doing a good job, and the following Monday you tell me that I am in default.

So when you talk about the time factor, and you talk about referring the matter for tort action, I just do not see that as the solution in these particular types of cases.

Mr. SANDERS. What do you see then as the solution?

Mr. MITCHELL. I do not know, I really do not know. And I am going to have my staff, as I indicated, look at these six and others, and see if we can define more sharply what the problem is. And then maybe once we do that, then I can come back to you with some recommendations.

Mr. SANDERS. I would be pleased to receive them, Mr. Chairman.

Mr. MITCHELL. Thank you.

Mr. Daub.

Mr. DAUB. Mr. Chairman, thank you very much, not only for this time, but for calling this hearing today. I think that it is important that we do try to develop, particularly in economically restraining times the most workable bonding program that we can have. And I know that the Administrator is committed to that as well.

I would want us to be careful about using the word tort, because that is a wrong independent of contract. Many of these circumstances from my business experience arise from within a pursuit of a breach of contract. So hoping that no one is coming to blows over something like this, indeed the lawyer may be engaged in the process, and in fact there may have to be estoppel action.

And, indeed, I think that the Administrator is right. Because, as you said, Mr. Chairman, they do not find out about it until the night before, which is where the real problem is.

From the Weicker hearings, the Senate hearings, where are you now with respect to personnel, processing the claims, numbers part-time and full-time, college students; and what are your personal goals for trying to handle the surety bond claims procedure that is within your own control?

Mr. SANDERS. There are five full-time and two part-time permanent employees, along with four full-time cooperative students—(alternating work teams with four other co-ops)—and eight part-time college student assistants, whose work consists of processing or reviewing claims. In addition, there are two full-time permanent managers, three full-time permanent clericals and one other full-time permanent employee who serves as a claims investigative coordinator.

In addition, to the improvements described by Mr. Holloway, we have updated the Claims Training and Reference Guide to provide explicit instructions to assist newer employees in becoming independent processors more quickly. Also, the wider use of form letters in our claims processing operation has decreased the amount of time devoted to correspondence. We are presently studying other measures to increase our claims handling resources both in terms of manpower and further procedural improvements.

Mr. HOLLOWAY. Congressman, we have increased the staffing in the surety bond guarantee program to the point where we now have authorized about 33 people in our central office operation.

Mr. DAUB. Compared to what?

Mr. **Holloway**. That number is up substantially. I would say compared to probably in the neighborhood of 20 to 25 including the temporary and part-timers that are involved. In our field offices, we have a total of about 41 people now, 28 professionals and 13 full-time clericals.

That increase in staff has also permitted us to do a revision of our SOP's, a revision of our regulations, an updating of our claims handling handbooks, and that type of thing. Very definite and specific steps have been taken to improve the operation of the program.

Mr. **Daub**. Do you have any plans with respect to further activity?

Mr. **Holloway**. Yes, we have several items in our plans which we believe will improve SBG claims handling procedures:

First: The preparation of a surety handbook for SBA's/SBG default and claims processing which should eliminate much one-to-one, case-by-case explanation of what SBG needs from sureties to document its files adequately.

Second: The expansion and revision of SBA form 994J, report of default/claim activity, will provide answers to questions concerning contract completion arrangements now being requested on a case-by-case basis when not provided initially by the surety.

Third: Random sample review of claim payments processed, rather than case-by-case review as presently done, will save time. The consequence of public and internal criticism must be recognized and accepted if this procedure is to be adopted.

Fourth: Implementation of the plan to use technical consultants to assist the SBG claim investigative coordinator in verifying facts pertaining to particularly complex or suspect claims cases.

Fifth: More intense training of part-time temporary employees and upgrading the training of permanent employees will result in better quality case analyses.

Sixth: Converting to on-line computer processing, previously mentioned, will also save file retrieval and paper processing time.

Mr. **Daub**. Do you think now that about 2 years is enough for some lawyers to have a contract with the SBA to draft the guidelines for such an agreement; are we going to see something here pretty soon?

Mr. **Holloway**. Yes, sir.

Mr. **Daub**. We have had a contract for 2 years now, right, to try to get this treaty language worked out?

Mr. **Sanders**. That was the very question that I asked this morning. Evidently, the work predates my arrival at the agency, and I think that it is time.

Mr. **Daub**. Has it yet reared its ugly head on your desk?

Mr. **Holloway**. You are going to see an advanced notice of proposed rule making in the Federal Register in a very few weeks now.

Mr. **Daub**. Well, that is terrific.

Mr. **Sanders**. Do you want to lay some money on that, Ed?

Mr. **Daub**. I did not want to comment on it one way or the other. I even hesitated to use the word terrific.

Mr. **Sanders**. I will put $5 on the side by July 1.

Mr. DAUB. I think that we will try to refrain from any of that type of gamesmanship in Congress. It has gotten other Members preceding me in trouble.

I wonder about your impression, Mr. Administrator. You heard some testimony from Mr. Colbert and others here. And I just got in on a little bit of it. I apologize for having other business that delayed my arrival at the committee.

Do you have any other insight, any other concerns, any other comments about his case that you can say with the admonition that the chairman gave us earlier, or others similarly situated. I do not know if you have seen or are aware of the other five or six cases that the chairman knows about yet, but I hope that you will work and your counsel will work with this staff counsel, so that we can get at some of the repeating problems that seem to be around.

You know how it is with headlines. There are always five, six, or seven out of 2,000 that do get attention. But they could be instructive, as the chairman said, to ways in which we can as a matter of policy avoid some difficulty in getting more of this business out into the hands of the private surety people, and maybe less of a problem with claims within the department, where I guess I would argue that maybe we do not have any business doing this in some ways. It is difficult.

You have heard his story. Is there anything further that you wanted to add to that?

Mr. SANDERS. Well, I think that I share Chairman Mitchell's concern about some of these situations where minorities have been taken advantage of, some unscrupulous prime contractors, perhaps, or large subs. I do not know the cases, of course.

But, sure, those things go on, and they go on in the nonminority area. And I think that to the extent that we can discover the reasons behind them, and what is going on, maybe we can address them. I doubt very much that we can address them through the bonding program. But perhaps we can do some other things.

But at least let us find out what the root causes are. And wherever we have a bonding company that is somehow profiting by the defaulting of a contractor, then there is something seriously wrong.

Mr. DAUB. Let me find out for my own information, since I did not get here early, and I am not familiar.

Mr. Colbert's case, when did it start, 2 years ago, 3 years ago, a year ago?

Mr. SANDERS. We have some background on that, and it is available to all of you, and the IG's investigation of it.

[Material referred to above follows:]

SYNOPSIS OF EVENTS CONCERNING COLBERT REFRIGERATION AND COLOK, INC.

Colbert Refrigeration—SBG-0300-38416-011-40; SBG-0300-38416-012-42; Bond #1213 & 1214.

Colok, Inc.—SBG-0300-37119-001-37; Bond #1122.

Mr. Charles Colbert is the principal for both Colbert Refrigeration and Colok, Inc.

7/7/77.—SBA was advised of default under Colbert Refrigeration. This contract was for mechanical work at La Plata High School, principal's default was due to extremely poor planning and workmanship.

7/7/77.—SBA was advised of default under Colok, Inc. This contract was for mechanical work at the Addison Road Station in Washington, D.C. This project was seriously behind schedule, delays due to a flood of change orders.

9/15/78.—Principal defaulted under Colbert Refrigeration. This project was for mechanical work at Langdon Park East Recreation Center.

10/16/80 and 11/24/80.—SBA received status report advising that contract funds and remaining payment claims were tied up in litigation.

9/18/81.—The Office of Inspector General performed an Internal Audit on Colbert Refrigeration, and Colok, Inc. The I.G. found no significant deficiencies. However, the F.B.I. had been involved in Colbert Refrigeration, since principal has diverted $52,000 in contract funds by forging signatures of other joint payees. Surety recovered $32,000 and made up the difference.

9/29/81.—Mr. Colbert called the SBG Branch, Ella Luke took the call. Mr. Colbert wanted to know if SBA had any claims from Dependable Ins. Co. in his file. He was told that SBA had claims from Dependable, but was not given specific information concerning the claim.

10/8/81.—Mr. Colbert called our office again, Norma Nelson took the call. Mr. Colbert alleged that Dependable made illegal payments on his behalf regarding La Plata School.

10/16/81.—Mr. Colbert called Ms. Luke again, and asked her (in confidence) for the exact amount SBA paid to Dependable. He was told that if he wanted information concerning claims, he would have to send us a request in writing.

10/22/81.—SBA received a request for information under the Freedom of Information Act, from Mr. Clifford E. Barnes, Attorney. On the same day Mr. Colbert called Ms. Luke, and wanted to know how long it would be before his attorney would receive the requested information.

10/29/81.—Arrangements were made for Mr. Colbert to pick-up documents released by OSG, under the F.O.I.A. At 4:15 p.m. same day, Mr. Colbert called Stu Harbour, stating that the documents were no good, and that they would be no good in court. Mr. Harbour informed him as to the information that could be disclosed.

10/30/81.—Mr. Kalcounos asked Ella Luke to send him undeleted copies of what we gave Mr. Colbert. This office complied with that request.

11/3/81.—Mr. Colbert called Mr. Armstrong, stating his dissatisfaction with documents furnished under the F.O.I.A. Mr. Armstrong told him we felt we had furnished all the information we could under the law.

11/16/81.—Mr. Colbert called Norma Nelson. He again wanted to know if SBA paid the amount of the surety claims, and if SBA were to be taken to court, would SBA give the Surety the right to recover for it (SBA).

1/13/82.—Mr. Colbert called Howard Huegel. Mr. Colbert wanted us to look into the case that Dependable was cheating the government. Also, he has court papers to prove it. Mr. Colbert implied threat of going to the papers. Howard asked if he had contacted our S&I, or our attorneys. The answer was "No, he had not."

4/29/82.—Charles Colbert, Major Clark (Assistant to Congressman Parren Mitchell), John Wood (Attorney for Colbert), Carl Ellison (SBA/MSB Representative), met with Arthur Armstrong (Director, Office of Special Guarantees) and Norma Nelson (Claims Manager, SBG Branch). Colbert claimed that Surety completed work that Colbert was not contracted to do, and billed SBA. IG investigation was mentioned, Clark was advised that SBG does not have the staff to do such in-depth investigations. Nelson told group that SBA needs evidence of Surety wrongdoing if the matter is to be investigated further. Woods responded that evidence would be sent to SBA. No evidence has been received.

5/20/82.—Letter from Edwin T. Holloway, Assistant Administrator for Finance and Investment, to John S. Wood, attorney for Colbert.

6/21/82.—Letter from Holloway to Wood. Advised that the actions of Surety are those which have long existed in the suretyship law of several states. SBA does have regulations relating to a surety's conduct in the Surety Bond Guarantee Program, but SBA has not been presented with evidence that Surety is guilty of the conduct prescribed by the regulations.

5/16/83.—To date SBA has paid a total of $802,279 in claims, of this amount $299,749 was paid under Colok, Inc.

5/17/83.—Hearing before Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, House Committee on Small Business.

6/23/83.—SBA is presently in active discussion with Mr. Colbert and his attorney's exploring whether SBA should take any further steps.

Mr. DAUB. And you do not think that there is anything that we can do about the unreasonable legal fee and collection problems that exist?

You commented a moment ago, that you thought that the fees were too high, but that that was the hardball game that everybody was in.

Mr. **Sanders**. Well, I think that the business integrity regulation will control some of these factors. Don't you, Ed?

Mr. **Holloway**. Yes, sir, I believe it could. We in February adopted a final regulation calling for what we call a business integrity regulation. It will give us a legal basis, if you will, to discontinue doing business with any sureties or agents that we find to be unscrupulous.

Mr. **Daub**. So that could get to legal fees and other things, collection fees, and problems in that regard?

Mr. **Holloway**. Yes, sir, it is the best tool we have.

Mr. **Daub**. I need some data. The staff and I have worked on trying to get some of this information. If you do not have the information now, would you please submit it to us? I think that the members of the committee should have it.

Can you tell me precisely what is your present backlog of surety claims?

Mr. **Halloway**. The backlog of surety claim payments was 151 at the end of May. This figure, however, is not representative of the total work and workload within the claims unit. The work associated with the surety bond guarantee claims is accomplished by four teams: One, new file and underwriting review; two, active claims; three, subrogation and recovery; and four, program and surety company.

The work involves the review of new files in default to determine the legality of the guarantees and the denial of liability where the guarantees were issued under improper circumstances; the analysis of the underwriting considerations which prompted SBA's guarantee; the review and analysis of each surety's submissions of claims for reimbursement; the monitoring of the status of the project as reported by the surety; the adequate pursuit of indemnitors which often result in a mitigation of SBA losses; the resolution of cases hopelessly defunct; and the reinstatement of cases which cause no loss to SBA or which arrange a legal settlement. The thorough reviews and analyses presently being done by the claims staff on SBG cases in default has evolved from our experience which indicated that many cases after default were not being given adequate attention by the surety company, and from the conclusion by other offices and oversight groups—e.g., GAO, BGA, SBA's OIG, and the Congress—that such reviews were necessary on a case-by-case basis to prevent or identify wrongdoing against the SBA and the taxpayers.

Mr. **Daub**. Can you tell me how long it takes, approximately, for you to pay on a claim, and how that would compare with a year ago, and indeed if you see a difference?

[Response to above follows:]

The average processing time for a claim from the date SBA receives it until the Surety receives the payment is approximately 30 days. There are, however, several circumstances that will cause a delay in processing a claim. For example:

(1) If it is a new default, Central Office has to request the underwriting file from the regional office.

(2) If there is a need to refer the file to OGC or OIG.

(3) If there are any problems with the claim itself or the surety's billing methods.

(4) If the SBA Form 1101, "SBA Modification/Administrative Action Keypunch Format," document used to input payment information in the computer, rejects for any reasons.

In the above examples, processing time can vary from 60 to 120 days or longer, depending upon the complexity of the problem.

Overall, there has not been any significant change in the claim processing time within the last year.

Mr. **Daub**. If you are objective about your own figures, could you comment whether you think that is acceptable within your manning levels, or not acceptable in terms of a period of time that may go by from a claim, to checking it out, to processing it, and paying it?

[Reply to above follows:]

Accordingly to our Guarantee Agreement, SBA agrees to reimburse the surety on its loss within 90 days of actual receipt by SBA of payment request. We feel that our approximate 30 days processing time is acceptable with our present staff.

Mr. **Sanders**. Paying it to the surety company?

Mr. **Daub**. To the surety company, right. If you would let us know. I think that we should have an idea of the overall numbers that you are handling now with your higher number of personnel on board, both full-time and temporary, and let us compare that with a year ago, to see what kind of progress you are making.

Also, you may want to submit to us how many claims underwriting reviews that the SBA is now conducting, and how often each surety that participates gets reviewed, to give us some idea of frequency of checking on those that are participating in the program now.

[Response to above follows:]

Since the Senate hearings, Surety Bond Guarantee Personnel have conducted nine surety company reviews. Several other reviews were planned but could not be done due to staff limitations and the resignation of two key employees.

Eight of the nine reviews were of surety companies presently active in the program. The ninth review was that of a small standard surety which no longer participates in the program. One of the purposes of the review was to try to solicit interest to enter the program.

The SBG program tries to review the major participants (specialty sureties) more often than the relatively inactive companies.

Mr. **Daub**. The last question. Are you doing anything in getting more sureties interested in the program?

[Reply to above follows:]

Appropriate personnel from the Surety Bond Program have attended meetings and conventions of such organizations as the Surety Association of America, and the National Association of Surety Underwriters, etc. establishing a good working relationship with these groups. We have urged the field officers to attend the local Surety Association meetings to solicit local interest. We also feel that once the treaty is in effect, we will gain greater participation from the standard sureties in the SBG program

Mr. **Sanders**. Yes, the situations that I have alluded to. We have met with the National Association of Surety Underwriters. In addition to the firms that are represented here by Mr. Magnotti, we met with the majors. And I think that they are very interested in taking a strong level of underwriting in this matter.

Mr. **Daub**. We would appreciate that for the record. Before you leave, if no one else has any questions, I think that I would like to have a picture of you and the chairman together, and that will take about 10 seconds when the chairman may finish. I appreciate your time, Mr. Chairman.

Mr. MITCHELL. I am not at all sure that the Administrator wants such a photograph.

Mr. SANDERS. I want it.

Mr. DAUB. He wants it, Mr. Chairman. He wants it.

Mr. SANDERS. I want a blowup of it.

Mr. MITCHELL. And I am equally not at all sure that I want a photograph.

Mr. SANDERS. I think that that is more to the point.

Mr. DAUB. Oh, not at all.

[General laughter.]

Mr. MITCHELL. I did have one question with reference to this new integrity program. I am certain that you are flushing that out, that it is not a completed program yet, right?

Mr. HOLLOWAY. The regulation is adopted, and is in the Federal Register, Mr. Chairman.

Mr. MITCHELL. In terms of the implementation of this. If, for example, you saw one surety company which had in your opinion a grossly disproportionate amount of defaults, 60 percent concentrated in one surety company as opposed to 2 or 3 percent rate with other companies, would that be a sufficient cause of concern, that you would begin to get into the integrity question?

Mr. HOLLOWAY. Yes, sir.

Mr. DAUB. That sends up a red flag.

Mr. HOLLOWAY. Yes, sir, we could move on that.

Mr. DAUB. That is a good point, Mr. Chairman.

Mr. MITCHELL. Thank you, very much, gentlemen.

There are three other witnesses. I just want to apologize to the other three witnesses. We will do this very, very quickly, and get it out of the way.

Meanwhile, if Mr. Marchbanks from the Minority Development Financing Board will come up; and Mr. Lloyd Provost from the Surety Association of America; and Mr. Richard Schuerholz, chairman of the Small Business Committee of the Surety Association of America. If you three people would come to the witness table.

[Pause.]

Mr. MITCHELL. Thank you, for being patient. I think that we have copies of all of your testimony. And if you so desire, you can merely give the highlights of your testimony.

Mr. DAUB. And identification of them, too, so we know who is who.

Mr. MITCHELL. If I may, Mr. Daub, I called those names off, and each witness will identify himself when he presents his testimony. I do not know who wants to lead off. And if you would give your name for the record.

TESTIMONY OF LLOYD PROVOST, PRESIDENT, THE SURETY ASSOCIATION OF AMERICA

Mr. PROVOST. My name is Lloyd Provost, and I am president of The Surety Association of America, which is a trade association of companies writing fidelity and surety bonds.

I have been asked to give some background to a proposal which the Surety Association has made to the Small Business Administration, which we hope will encourage a greater participation of major surety companies in the SBA Surety Bond Guarantee program.

Mr. Richard Schuerholz, vice president of the Fidelity and Deposit Co. of Maryland, who is chairman of the association's subcommittee on small contractors is with me today, and he will explain the actual proposal. And we shall both try to answer any questions that you may have.

When the bond guarantee program was originally enacted, the senior executives of the major surety companies were asked to and did set up an industry-wide committee to work with the SBA to establish the mechanics of the program.

Initially, these executives thought the entire program would be written by their companies. And consequently, they suggested that it be structured to obtain maximum company participation.

Also, it was believed that most of the contractors in the program would be minority contractors. While Congress had not set forth such a limitation, and there is some question whether it would be constitutional to do so, it was recognized that the minority groups had much to do with the enactment of the program.

The original 90–10 split for premium and losses was adopted to encourage the major surety companies to work with the program. The program started off slowly, and not all of the major companies initially participated in it.

Then two unexpected things happened. In the fall of 1973, the Israeli-Egyptian War broke out, the price of oil tripled, and double digit inflation fell upon us. Contractors failed in droves, and surety companies either stopped writing contract bonds, or drastically tightened up their underwriting.

Many found that they had contractors on their books who could no longer qualify for bonds under their new stricter underwriting standards. And these contractors were encouraged to utilize the SBA program. They were not necessarily minority contractors. And this had a lot to do with the existing minority percentage in the program.

The second unexpected occurrence was the appearance of specialty surety companies. These companies were for the most part existing small insurance companies that had not previously written any surety business, but decided to write bonds just in the bond guarantee program.

As the specialties grew, the major companies which originally thought that they would be the only ones in the program found that there were others out there actively soliciting the business.

Now there is no question that for major companies underwriting an occasional SBA bond is not the most productive thing that an underwriter can do. Forms must be filled out, and the underwriting generally requires some special treatment.

In addition, the premium involved in a SBA case is relatively small. As a result, it became easy for the major company underwriters to refer potential SBA cases to the specialty markets. And that is exactly what has happened.

We now find that the specialty market is writing about 97 percent of the business. Notwithstanding this, the major companies have always supported the SBA program, but their minimal participation appears to negate this.

Therefore, almost 2 years ago, the Surety Association of America appointed a subcommittee to study the overall subject of bonding small contractors. The subcommittee reviewed many different alternatives, such as establishing a separate surety company for small contractors, or forming various pools or market assistance plans.

After much discussion, it was decided that the existing Surety Bond Guarantee Program offered the most realistic solution, and a proposal was developed to encourage more active participation of the major companies in the program.

Mr. Schuerholz will provide the details of this. Thank you.

[Mr. Provost's prepared statement follows:]

PREPARED STATEMENT OF LLOYD PROVOST, PRESIDENT, THE SURETY ASSOCIATION OF AMERICA

My name is Lloyd Provost and I am President of The Surety Association of America which is a trade association of companies writing fidelity and surety bonds.

I have been asked to give some background to a proposal which the Surety Association has made to the Small Business Administration which we hope will encourage a greater participation of major surety companies in the SBA's Surety Bond Guarantee Program. Mr. Richard H. Schuerholz, Vice President of the Fidelity and Deposit Company of Maryland, who is chairman of the Association's Subcommittee on Small Contractor is with me today and he will explain the actual proposal and we shall both then try to answer any questions you may have.

When the Bond Guarantee Program was originally enacted, the senior executives of the major surety companies were asked to, and did, set up an industrywide committee to work with the SBA to establish the mechanics of the Program. Initially these executives thought the entire Program would be written by their companies and consequently suggested that it be structured to obtain maximum company participation. Also it was believed that most the contractors in the Program would be minority contractors. While Congress had not set forth such a limitation and there is some question whether it would be Constitutional to do so, it was recognized that minority groups had much to do with its enactment. The original 90/10 split for premiums and losses was adopted to encourage the major companies to work with the Program.

The Program started off slowly and not all the major companies initially participated in it. Then two unexpected things happened. In the fall of 1973 the Israeli-Egyptian war broke out, the price of oil tripled, and double digit inflation fell upon us. Contractors failed in droves and surety companies either stopped writing contract bonds or drastically tightened up their underwriting. Many found they had contractors on their books who could no longer qualify for bonds under their new, stricter underwriting standards and these contractors were encouraged to utilize the SBA Program. They were not necessarily minority contractors and this had a lot to do with the existing minority percentage in the Program.

The second unexpected occurrence was the appearance of the specialty surety companies. These companies were, for the most part, existing small insurance companies that had not previously written any surety business but decided to write bonds just in the Bond Guarantee Program. As the specialty companies grew, the major companies, which originally thought they would be the only ones in the Program, found that there were others out there actively soliciting the business. Now there is no question that, for major companies, underwriting an occasional SBA Bond is not the most productive thing an underwriter can do. Forms must be filled out and the underwriting generally requires some special treatment. In addition, the premium involved in an SBA case is relatively small. As a result, it became easy for the major company underwriters to refer the potential SBA cases to the specialty market and that is exactly what happened. We now find the specialty market is writing about 97 percent of the business.

Notwithstanding this, the major companies have always supported the SBA Program. But their minimal participation appears to negate this. Therefore, almost two years ago the Surety Association appointed a Subcommittee to study the overall subject of bonding small contractors.

The Subcommittee reviewed many different alternatives, such as establishing a separate surety company for small contractors or forming various pools and market assistance plans. After much discussion it was decided that the existing Surety Bond Guarantee Program offered the most realistic solution and a proposal was developed to encourage more active participation of the major companies in the Program. Mr. Schuerholz will provide you with the details of it. Thank you.

Mr. MITCHELL. And a special welcome to you, Mr. Schuerholz, because of your residence.

Mr. SCHUERHOLZ. I am also a church member in your congressional district, so I have seen you many times there.

Mr. MITCHELL. That enhances your prestige.

Mr. SCHUERHOLZ. I am also on the subcommittee of the Greater Baltimore Committee that is involved with this Council on Equal Business Opportunity, and I look forward to seeing some results in Baltimore.

Mr. MITCHELL. Mr. Schuerholz, let me interrupt you for just a moment. I must confess that some way or other, I did not get your testimony. But present it, and I will read it later. But I would hope that somewhere along the line, you would refer to this very innovative new approach that is being tried in my city and State involving the bonding companies and the Council for Equal Business Opportunity, if you can.

Mr. SCHUERHOLZ. I would be delighted to. Would you like me to do it now?

Mr. MITCHELL. Fine.

TESTIMONY OF RICHARD H. SCHUERHOLZ, CHAIRMAN, SMALL BUSINESS COMMITTEE, THE SURETY ASSOCIATION OF AMERICA

Mr. SCHUERHOLZ. Well, I think that the effort comes about as a result of a finding that was recently published in the papers of the U.S. Commission on Civil Rights that surveyed a number of the cities of the country, and found that Baltimore was cited for two conditions that were somewhat paradoxical.

One was that it was noted that the city of Baltimore had initiated many efforts to assist small and minority businesses but the bottom line results were that they were lagging far behind the other cities. And the effort was to attempt to determine what the conditions were that were leading to that.

The subcommittee of the Greater Baltimore Committee was formed with financial institutions, which was one subcommittee, and another subcommittee with respect to contracting for minorities. They being small businesses, and also being very intensive in a great deal of the Baltimore development.

The subcommittee is made up of bonding experts. And I do not know how I got on that, but I guess that a rumor went around. There are several contractors, major contractors, and several of the trades that are participating in a joint effort to bring bonding to the level pretty much what this committee is listening to today in testimony, that is to say bring the bonding function to the grassroots of the community, so that there will be a better understanding of it, and at the same time to set up a facility whereby the bonding underwriters can review and qualify minority contractors in the way that traditional underwriting has somewhat bypassed the effort. We have had several meetings, and the banks, I think, have come through with substantial funds for loans. And we are working closely with them, because it is a hand and glove activity. We would hope that the same commission in a very short time would find positive results out of this committee, and will see that the corrections that have concerned all of us in Baltimore have been remedied to a large degree.

Mr. MITCHELL. Thank you.

Mr. SCHUERHOLZ. I am at somewhat of an advantage, because I have listened to all of the other testimony. And if I could, with your permission, I will leave my testimony before the committee, and just touch on the highlights to save some time.

Mr. MITCHELL. That would be very helpful. The entire testimony is submitted for the record.

Mr. SCHUERHOLZ. The thrust of my statement is to attempt to identify what I consider as two main problem areas with respect to bonding for minority contractors. One has been the cost factor, and that must be admitted to by, I think, everyone involved with the bonding process. The cost of solicitation, the cost of underwriting, the investigation, production, the placing of the business on the books, and the administrative costs that involve both SBA and the underwriters. Second, I think that this may have been the greatest reason why the second problem exists. And that is what I referred to as a linkage with the grassroots. There does exist a great deal of expertise in underwriting and production, and the net work of agents, and the bond underwriters that simply have not reached down or into the levels where the minority contractor is performing his work. There is very little expertise among agents in general with respect to surety bonding. Consequently, I think that much of the testimony that we have heard relating to the inability of contractors obtaining bonds, from what I have observed at many of the meetings that I have attended here in Washington and elsewhere, many contractors are simply inhibited from even taking that to public plans, because they know that there is a bond in the picture. And they are inhibited by the fact that they know that there is going to be a flurry of investigations, and paperwork, and so forth. Much of it, I think, can be allayed, and indeed encouraged to reach out and bring these people before the procurement process, so that they would be more comfortable in coming out and being a participant in the program. With those two problems in mind, our proposition to the Small Business Administration would be essentially this: To place the underwriting and claims handling functions more in the hands of the bonding companies that have the expertise and the capabilities of performing arising out of their experience.

It is extremely difficult to promulgate regulations that will specify how much working capital a given contractor needs. In our opinion, this would lead to the very pragmatic decisions that have to be made for small businesses. We do not need sophisticated CPA statements, and schedules, and so forth, where functionally there is a judgment made that the contractor indeed can perform that particular contract. One of the elements of our proposal would be that the bonding companies that would participate in this would be qualified by the SBA by meeting certain criteria. In addition to being on the Treasury list, these companies would have the capacity to graduate these contractors, which is a legitimate goal, I think, that is established even by the law; and the review levels by which underwriting and claims handling are handled would be publicized. It would reserve to the SBA the particular administrative functions to see to it that these performances by the companies are adequate. However, the actual day to day decision making on bonding would be made by the companies. This would result in greater economic efficiencies to the Federal Government via the SBA program to the companies, and indeed to the producers and the contractors. It would eliminate a great deal of forms, multiplicity of forms. And the turn-around time for decision making in getting that bond will be greatly reduced. It was mentioned earlier today about the inconsistent interpretation of regulations. And I think perhaps that this would be a problem that would be addressed by our proposal, in that the regulations that specify certain types of technical information would not be placed in the hands of the surety companies. It will provide for a larger retention of the risk by the bonding companies. And this would be saying that the surety companies will be putting their money where their mouth is. If we are going to take a larger role in this kind of decision making, and bind the SBA and the Federal Government to indemnify part of our loss, we stand willing to accept a little more of the risk going in. It will provide for a rate structure that will be equal to the standard market. And I addressed the cost of administering this program earlier. There are two ways that the cost can be resolved with the participants. One is to find greater efficiencies, where the other is to raise the price. Our feeling is that this program would concern itself with greater efficiencies rather than burden the contractor with an increase in the bond fee. Probably most importantly, it will bring about a greater outreach into the grassroots where the potential contractor resides. This will be done by a commitment that our company stands ready to promote the SBA program through its network of producers, and bring to their attention the efficiencies and the capabilities of being able to write these risks at the level where they have been traditionally most comfortable, and for a campaign by which the bond producers themselves can provide the expertise.

I would fully agree with Mr. Thomas' testimony that the educational process here is something that needs a lot of work. And the workshops that they have undertaken, I think, coupled by the efforts by the bond producers jointly and collectively would bring about the desired result of contractors being better prepared to qualify for bonds at the outset.

In summary, our proposal would bring about these results. It will be a cost efficient program to all the participants. It will embrace a more meaningful segment of the construction industry comprised of minority contractors.

It will greatly facilitate accessibility to public works and the bonds required thereunder, which I think is probably the most important of the goals that would be undertaken here.

And finally, it will engage the major writers to a greater extent, and bring important advantages via their professional staff counseling and service to the minority contractor. The enactment of the necessary law to bring about this proposal, and to get it implemented is strongly recommended by the subcommittee of the Surety Association. And on behalf of the association, I would like to thank you for the opportunity of making this presentation.

[Mr. Schuerholz' prepared statement follows:]

PREPARED STATEMENT OF RICHARD H. SCHUERHOLZ, CHAIRMAN, SMALL BUSINESS SUBCOMMITTEE, SURETY ASSOCIATION OF AMERICA

My name is Richard H. Schuerholz, vice president, Fidelity and Deposit Co. of Maryland, and I am in charge of the surety department. The Fidelity and Deposit Co. of Maryland is one of the major surety bond underwriters nationwide. As a member of the company's home office underwriting staff for over 25 years, I have had firsthand experience with the development of programs designed to minority contractors in qualifying for bonds. I have been an active underwriter of risks pursuant to these programs, and I maintain a close liaison nationally and locally with organizations with which we share a common interest in the welfare of the minority contractor. These experiences involved me in 1969 with the initial steps that led to the formulation of the SBA/SBG program, and the related activities during that time and up to the present. Similarly, I have participated with the minority contractor community, both individually, and with their association in arranging for specific bonding assistance: and solving many bonding problems.

We must not lose sight of the unique characteristics of the minority businesses. Their numbers are many, and vary immensely in terms of size, organization, experience, financial condition, and specialty. In the interdependent environment of American commerce, the minority business requires a unique approach and degree of attention than their majority counterparts. Particularly to credit extenders, bankers, retail credit managers, and we the bond producer/underwriter, they involve a commitment of resources to service their needs that to date had incurred very special expense factors both to the bond applicant and the producers of those bonds.

More to the point, on a per unit and per client basis, the cost of gathering data, development information, investigation, verification of credit, servicing, and monitoring has a direct bearing on providers of bonds—the producer, the Surety Company and where involved, the SBA.

The economic of bonding the small, and especially marginal-risk-clients are measured by many influencing factors such as future growth potential, prospects of successful venture, and the degree of risk or loss exposure.

Small contractor bond production/underwriting and servicing, in short, requires a special form of specialization by producers and companies for it to be economically feasible to provide maximum access to the surety market. Those of us who are engaged in this field of underwriting must remain sensitive to these factors in response to the needs of the minority contractor.

I have dwelled on this aspect to some extent as it is the very root of the problem which our subcommittee has attempted to address with its endorsement of a more strengthened SBA surety bond guarantee program to broaden its base of service to the minority client through a greater participation of the major writers and at significant cost savings at all levels—the government, the surety producers, and underwriters, and the client.

The conclusion that our subcommittee made in selecting the SBA/surety bond guarantee program and improving upon it—as the most desired choice of our industry's strategy to obtain a more meaningful participation in the SBA/SBG for the benefit of the small and minority contractor, has been premised on these considerations:

(1) The SBA has over a quarter century of expertise in serving the interests of small and minority contractors.

(2) SBA surety bond guarantee is a program now in place—and that its effectiveness is limited only by some unwieldly mechanics that has created an untapped potential and underutilization by the major writers—a problem that we are convinced is solvable.

(3) A strengthened SBA surety bond guarantee program would best solve or at least significantly narrow the gap of bond accessibility to minority contractor.

(4) The SBA surety bond guarantee program is considered as the most economical, cost effective, and far reaching program available to the major surety writers and their vast network of producers.

(5) The existence of SBA resources as specialists in matters affecting small and minority business combined with the professional resources of the producer/underwriters' skills in risk-taking makes the SBA surety bond guarantee program a for-

midable vehicle for enabling our industry to more effectively demonstrate its commitment to small and minority businesses.

No amount of promotion or admonishments to our producers and underwriters and SBA's staff could be expected to gain results if we didn't undertake to diagnose the modus operandi of all levels of activity of SBA surety bond guarantee program, and find improvements for enlarging SBA's outreach to minority contractors. This, the subcommittee attempted, and, we have developed a proposal in concept that we believe addresses the main problems that have to date stymied the achievements of the program's main objectives and goals in this area.

Our proposal has now been accepted in broad principle, by SBA surety bond guarantee, by the major writers represented in the surety associated and by the associations of major surety bond agents. SBA's tentative acceptance is subject to certain enabling legislation we hope will pass. There will probably be some further refinements to the proposal by the companies. In essence, however, our proposal embraces these features with no major change anticipated in concept.

(1) A streamlining of underwriting development, reporting, and commitment of SBA surety bond guarantee indemnification where the companies will assure a major portion of these functions. More pragmatic decisions in favor of the bond applicant will result from the years of experience and professional judgment of the producer and underwriter.

(2) Eligibility requirements for companies qualified to participate, which include broad statements of underwriting policy, underwriting authority, claims' handling procedures, and levels of review, staffing, and other factors to preserve the integrity of accountability and the legal obligations of SBA as prescribed by law. Such companies will be engaged by SBA in the plan by a special operational agreement.

(3) Forms, documents, multiple copies and multiple distributions of data will be drastically reduced, and in many instances, eliminated.

(4) Decisionmaking turn around time will be reduced.

(5) The SBA surety bond guarantee role will be essentially one of administration of the program: The company's role will be essentially the underwriting and claim handling function. In other words, the respective expertise of both will be assumed almost exclusively. By each, and not duplicated or overlapped.

(6) It will provide for a larger percentage of risk retention to validate the company's commitment of SBA's indemnification without inhibiting production initiatives.

(7) It will provide a rate structure from these economies that will be closer aligned with that charged in standard risks.

(8) It will provide the economies to better interest producers in soliciting and servicing the marginal SBA client.

(9) It will provide for a greater outreach into the grassroots level of potential clients, many of whom have had limited experience with surety bonds and whose concern of "bonding problems" are believed to have arisen as much from intimidation or lack of knowledge, as the deficiencies on merits of the risks.

(10) It will provide a more effective facility for graduation in the standard market provided by the major writer.

(11) The proposal is not a replacement—only a supplement—to the existing procedures. A specialty segment of our industry has provided an important access to the surety market, and those activities will not be affected. The adoption of our proposal will broaden the outreach of bond accessibility in areas where the client can avail himself to another source of expertise reposed in the major surety company staffs and producers.

The minority contractor bond applicant must have access to professional surety specialists who can provide the needed services in facilitating their potential for qualifying for bonding—or can be counselled on their deficiencies. The objective of the proposal is to cultivate that relationship more effectively.

In summary, the implementation of our proposal:

(1) Will be cost efficient to the government and all participants in terms of administration and loss control.

(2) Will expand to embrace a more meaningful segment of the construction industry comprised of minority contractors.

(3) Will more greatly facilitate accessibility to public work and bonds required thereunder.

(4) Will engage the major writers to a greater extent and bring important advantages vis-a-vis their professional staff, counselling, and service to the minority contractor.

I thank you for affording me this opportunity to be with you to express our position and present our recommendation for your consideration on this important matter.

Mr. **Mitchell.** Thank you. I have one or two questions, but I want to hear from Mr. Marchbanks first, who came into my office about 6 months ago with a really new and pioneering effort that has been started in the State of Ohio. And that is why I was most anxious for you to be here to give testimony. Thank you for coming.

TESTIMONY OF JACK R. MARCHBANKS, EXECUTIVE DIRECTOR, MINORITY DEVELOPMENT FINANCING ADVISORY BOARD

Mr. **Marchbanks.** Mr. Chairman, Congressman Daub, my name is Jack Marchbanks, and I bring you greetings from Ohio Governor Dick Celeste, and from State Senator William Bowen. I serve as executive director to the Minority Development Financing Advisory Board. The board is a quasi-public corporation. The State of Ohio about a year and a half ago got into the surety business in a manner of speaking. It earmarked $10 million in State funds to capitalize a State surety program that specialized in bonding minority construction contractors. The minority legislators in Ohio pioneered this effort because minority construction contractors particularly in Ohio had an extremely difficult time securing bonding. I would like to, with your permission, Mr. Chairman, leave most of my testimony on the table and speak to some of the ways that I think that we can address the issue that I have heard spoken of today, and that is how we can better protect minority contractors from default under SBA guaranteed bonds.

Mr. **Mitchell.** Your entire statement is submitted for the record. I might ask you to go back a little later on, and give us a little more detail. I am familiar with it, but a little more detail on the Ohio program would be desirable. Meanwhile, why do you not speak to the issue of protection against default under the Surety Bond Guarantee Program.

Mr. **Marchbanks.** Thank you, sir. Surety by definition means protection. A surety bond is a three-party instrument among the owner, the surety, and the contractor. It is not the surety's business to pay defaults. It is the surety's business to prevent defaults. And by doing so, they protect themselves, they protect the contractor, and they satisfy the owner by insuring performance. What we have seen in Ohio, what we have been implementing as protections against default by minority contractors are three things. And before I tell you what the three things are, I would like to mention that the situation in which default will occur most insofar as our experience is concerned is that arrangement in which a minority contractor is required to have a bond-back to a prime contractor. Often this is a hostile situation. And because of that, the surety has to be twice as cautious in forestalling allegations of default in the eleventh hour, as has been complained about here today. What we do before we bond a minority contractor in one of these situations is attempt to find out if the guy is going in with the strong possibility of loosing his shirt. We review his bid to make sure that he has not woefully underbid. If the bid is within range in our opinion, we secondly try to get our consulting project manager, and we have a professional engineer that consults with us, we try to get the situation established in which our consulting engineer coinspects the progress of the project. That coinspection goes along with that of the owner. The reason why we try to get this co-inspection is that we accomplish a paper trail of how much of the job is complete, and it protects the minority contractor when a default claim strikes at the eleventh hour. Finally, we try in every instance to screen the situation, and make sure that this is not such a volatile project that the contractor is going to be in trouble. But with these three elements, we avoid a default. We are a brand new program, as the chairman mentioned. But we have avoided default for over 2 years. And we have bonded in several instances minority contractors back to prime contractors, but these were nailbiting bonds. I speak to you from the standpoint of a surety underwriter, because we are in essence a surety producer for minority contractors in Ohio. Mr. Chairman, I will get back to some highlights of our program in Ohio. I feel that the program in Ohio is successful because we concentrate on a contractor's track record. As was mentioned here earlier, the working capital and net worth requirements often demanded by sureties cannot be met by many minority contractors. Because we are State subsidized, we can take a chance. And we have proven that a contractor is a good risk despite a weak financial statement, if they do have that track record. Second, we concentrate on the minority contractors in ways that we feel that your normal surety would not, precisely because the normal surety, as was mentioned here earlier, has several accounts, several large higher paying accounts. And for reasons of profit, these larger sureties naturally devote more time to their larger accounts. I think that these two reasons are the chief ones why we have been successful to date. We also have had much success attracting sureties who are committed to seeing minority contracts through to successful completion. I will not mention names of the sureties. But we have engaged at least $2 million of work in Ohio through private sureties who were impressed by the contractors who had performed well under our program. Once these contractors proved themselves, the sureties who for reasons mentioned before, technical reasons of poor financial statements on behalf of the minority contractors, changed their mind, and decided that these contractors were assumable risks. And these same contractors have also performed without default. We have also worked with the major banks in Ohio in establishing lines of credit. It was mentioned here earlier that subs get squeezed. They do not get paid on time, and then that midnight call comes along, and they are informed that they are in default. What we have accomplished is the extension of a $1 million line of credit in Columbus, Ohio alone for minority contractors. And we have gotten the bank to endorse our underwriting ability to the extent that they will lend to minority contractors at the bank's prime rate. The reason that I feel that they have extended such economical financing, working capital loans, to minority contractors is that we have proven to them that minority contractors, if properly screened, if properly coached—someone called it the education process—they can perform, and they can perform flawlessly. Mr. Chairman, I will answer any questions that you may have in regard to our program.

[Mr. Marchbanks prepared statement follows:]

PREPARED STATEMENT OF JACK R. MARCHBANKS, EXECUTIVE DIRECTOR, MINORITY DEVELOPMENT FINANCING ADVISORY BOARD, COLUMBUS, OHIO

Chairman Mitchell and honorable members of the committee, this testimony concerns the pioneering efforts Ohio has made in providing surety bonding for minority contractors based in the Buckeye State.

In November 1981, Ohio's Black state legislators boldly filled minority contractors' need for surety bonding by engineering a $10 million appropriation to fund a minority contractors bonding program. This program is administered by the Minority Development Financing Advisory Board (MDFAB). I currently serve as executive director to the Board.

WHY OHIO IS IN THE SURETY BUSINESS

Although Ohio passed a far-reaching minority business set aside law (one that is presently being challenged in federal court) in 1980, the Black legislators that sponsored the law found that it was ineffective because minority contractors generally could not secure bonding from private sureties. Without bonding, minority contractors could not qualify for contracts set aside by the state. Private sureties servicing Ohio defended their reluctance to bond minority contractors by stating that minority contractors were a "substandard market" which lacked the working capital and net worth necessary to qualify for bonding. So, in order to get minority contractors on jobs, the state "capitalized" its own surety company: the Minority Development Financing Advisory Board (MDFAB).

CAPACITY

As mentioned earlier, MDFAB has $10 million in cash reserves. The Board has recently leveraged this $10 million into $25 million in bonding authority. Hopefully, this increased authority will meet the burgeoning demand for bonding from minority contractors over the next two years.

WHY THE MINORITY CONTRACTORS BONDING PROGRAM IS SUCCESSFUL

The Minority Development Financing Advisory Board in reviewing applicants weighs the minority contractor's track record quite heavily. By doing so, it has shown that a proven performer is a good risk despite the performer's weak financial statement. By concentrating on the minority contractor's performance and character rather than his capital, as do private sureties, the Board gives the contractor a fighting chance. To date, the Board has suffered no defaults.

A second reason that the Board has been successful is that it is a specialty surety which concentrates on minority contractors alone. Often minority contractors do not get the attention they need from private sureties and bond agents because these firms and individuals, for reasons of profit, devote more time to their larger accounts.

A third factor which figures prominently in the minority contractors bonding program's success are its safeguards. Please note that the programs $10 million in cash reserves can only be touched in case of contractor default. Thus, the state is not expending actual dollars to support this program and the Board does its utmost to write good bonds so that defaults are kept at a minimum. It is also important to know that MDFAB does not directly compete with Ohio's private sureties, as it will only consider applicants which have been twice refused bonding by private sureties. Nonetheless, by being in the surety business, the state has catalyzed interest in bonding minority firms. In several instances, after the Board proved minority contractors could perform if bonded, private sureties have offered bonding to these same minority contractors who had previously been rejected.

RECENT DEVELOPMENTS

Encouraged by MDFAB's success, Transamerica has on referrals from the Board bonded over $2 million of work by minority contractors in three months. Huntington Banks of Ohio, also stirred by the Board's underwriting ability, has established a $1 million working capital line of credit for minority contractors referred to the bank by MDFAB. Qualifying contractors pay no more than the prime rate on these loans.

Mr. **MITCHELL**. Thank you, very much. I have some questions, and I know that Congressman Daub had some. But first, I wanted to talk to Mr. Schuerholz again, just briefly. In your testimony, you indicated that it is a little more time consuming and expensive to write the small bonds than it is for large bonds. Did you say something to that effect?

Mr. PROVOST. I did.

Mr. MITCHELL. Oh, you did, I am sorry. That is the case. Surety agents have been reluctant to do bonding for small contractors, because of the time and expense involved?

Mr. PROVOST. It has been one of the reasons why the major surety companies have not been that much involved in the SBA program. Certainly, an underwriter who generally is paid on the premiums that he develops, if he is working on a case that brings in $500 as opposed to one that might bring in $50,000, you know where he is going to spend his time.

Mr. MITCHELL. Let me ask you. Then the other thing that I have heard is that the large contractors sort of muscle out small contractors in the bonding field. Is there any validity to that? I think that maybe you have got two things going. Maybe the guy wants to make some money, and he is going to deal with the big contractors. That is one part, and you have spoken to that. And the other part is that the surety demands of the larger contractors, sort of squeezes the risk to the point that you do not want to deal with the smaller firms.

Mr. PROVOST. That is not exactly true. We tried to do a survey about 3 years ago with the major companies to find out just what their book of business consisted of. And we were very surprised to learn that a substantial part of the book of business, I would say in the percentages of 25 to 30 percent of the major companies' book of business, consisted of business that could have been written in the SBA program, if they wanted to. Now these were the better financed contractors, obviously, the ones with the track record. But they do write small contractors. That is how big contractors are made. And consequently, a surety company would like very much to nurture a small contractor into a big contractor, and continue to get his business all during the course of that time.

Mr. MITCHELL. Now I know that this was your testimony, and you have made a number of interesting recommendations. But I was a little concerned about page 4, item 7, among your recommendations. You suggested that obviously the companies give a larger percentage of risk. Then on 7 you say, "will provide a rate structure from these economies that will be closer alined with that charged on standard risks." Maybe I am misreading you. Are you suggesting that he will up the price really?

Mr. SCHUERHOLZ. No.

Mr. MITCHELL. OK, explain that to me.

Mr. SCHUERHOLZ. Presently, the major writers that are members of the surety association charge the same rate for the SBA guarantee contractor as we do for our standard client when we use that expression. There are deviations in rates between companies, and particularly these that may be specializing in the small business placement in the SBA program. The intent here is to simply say that we will preserve that same rate structure within the standard market by allowing us to meet our costs at a greater efficiency. It means that the rate that will be paid by a minority contractor or any contractor under the SBG program will be no greater than his counterpart written in the standard underwriter case.

Mr. MITCHELL. I see. Thank you, for that clarification.

Mr. SCHUERHOLZ. And that has been historical.

Mr. MITCHELL. I am quite familiar with your program. I have talked with you about it several times. But you stress track record. Under the Ohio program, you do not deal with new companies?.

Mr. MARCHBANKS. By law, it is required that a business be in operation at least 1 year. One of our largest contractors has been in business only 2½ years. But we do require that the minority contractor be in operation at least 1 calendar year prior to coming to our program. I should also stress that we are not in direct competition with the surety industry in Ohio. Because what we require, also, by statutory law is that the contractor be twice refused bonding from a private surety before coming to our program.

Mr. MITCHELL. One other thing. I think that it is very laudatory that you have a coinspection. Your engineer goes through, your consulting engineer goes through and checks everything out.

Mr. MARCHBANKS. Yes.

Mr. MITCHELL. But does that not add onto the time factor?

Mr. MARCHBANKS. No. We streamline the paperwork there. It is a matter of a one page sign-off from our contractor to us. We do not bicker with the owner or the prime contractor. We just document for our records where we feel that the job is in terms of completion. It helps us in defending the contract.

Mr. MITCHELL. My last question. It is not really a question maybe. You indicated that since this program has been in effect in Ohio, that you have gotten pretty good cooperation from the surety bond companies in the private sector, because of the thorough way in which you check out the companies before referring them. That is great. But is it also possible that they know that there is $10 million sitting out there; did they ever lose anything?

Mr. MARCHBANKS. Well, the $10 million sitting out there. When you say that, I am not understanding your question.

Mr. MITCHELL. The $10 million in cash reserve that the State has put up.

Mr. MARCHBANKS. We have not cowritten any bonds.

Mr. MITCHELL. Oh, I see. None at all?

Mr. MARCHBANKS. None at all. When we went into business in January of 1982, we went to all of the major sureties in Ohio, and tried to strike a cosurety reinsurance agreement between ourselves and whatever major surety would participate. None did. So the bonds that have been written by private sureties after our program got started have been totally assumed by the private sureties. They are just picking up business that they at first ignored. And this is all to the benefit of the minority contractors because we have a finite number of dollars. Whereas we have leveraged our bonding authority to $25 million, there is more than $25 million worth of work out there to be done. And whenever we can get assistance from "newly converted" sureties, we will take it.

Mr. MITCHELL. Congressman Daub.

Mr. DAUB. He is more tactful than we tend to be sometimes, Mr. Chairman. Your careful choice of words is observed with a humorous note in the record. But those kinds of laughs cannot be heard on the printed page. Let me ask either or any of you to respond, and your reaction to the proposal that the Small Business Administration vary its guarantee percentage on the basis of loss records compiled by sureties. Is that a good idea?

Mr. **Provost**. In our particular program, the proposal provides that the SBA would sit down with the standard company, once a standard company indicated that it was interested in going into this program, this type of program, and negotiate these details with them. And consequently, there might be some variations between the percentage of guarantee that the SBA gave one company as opposed to the other company.

Mr. **Marchbanks**. I am supportive of this recommendation. The varying percentage of guarantees will encourage performance by the sureties. I am a commercial banker by trade. And in writing guaranteed loans, I have often seen that the proper maintenance is not applied to a loan once a guarantee is attached. The bank, and I am using the word "bank" instead of surety company, the bank often walks away once the loan is underwritten. By varying the guarantee, you are penalizing and rewarding performance, and that is absolutely necessary, I think, of anything to be effective.

Mr. **Daub**. Mr. Schuerholz, would you care to comment?

Mr. **Schuerholz**. I have not been a real proponent of varying the amount of the indemnity. I think that that would depend on very carefully constructed criteria. There may be some administrative problems with that. And I think that the first question would have to be to look at how this would affect the interest of the contractor. My preference would be to go to a more stabilized, maybe one or two tiered type, variance, and then permit the program to be better constructed around the underwriting criteria in the policy.

Mr. **Daub**. So you could go from bad risk to better than bad risk, and then ultimately out of the program maybe, but start off with not maybe strictly some value judgment as to what the percentage ought to be, but on a more definite set of criterion put them in a lower risk or higher risk category to start with?

Mr. **Schuerholz**. That is correct. My feeling is that there is an indemnification or a retention level, however you want to look at the percentage. If the retention level by the surety is too low, obviously you are going to have the situation that once the bond is written, there is going to be a walkaway. If the retention rate comes in too high, because we have our own automatic treaty facilities, we probably already get that coverage anyhow. So I think that you are realistically talking between a range of say 20 percent to maybe 30 to 40 percent. If it goes higher than that, then I think that you have pretty much lost the ability of the contractor to get his bond in the first place.

Mr. **Daub**. Thank you, very much. Let me ask you en banc each of you to comment, if you care to, or any of you, on this question. If you would argue that there appears to be too few incentives for a surety to reduce expenses in the case of a default, what would you suggest would be appropriate incentives for the Small Business Administration to use?

Mr. **Provost**. Well, one of the things in our proposal is that a company could not get into this proposal without having its own legal department. And it presupposes that all standard surety companies have claim departments. They do sometimes when involved in litigation go outside. But the great majority of their work and the claims work would be overhead expense and a nonreimbursable expense from the SBA. So consequently, that would tend to, I think, keep down the legal expense growing out of the program.

Mr. SCHUERHOLZ. Essentially, there are two classifications of losses. One is a pure bond loss, which is doing a performance bond, and that is the cost to complete. The second type of loss is the loss under the payment bond, which is the loss that the surety sustains in paying off the bills of suppliers, laborers, and the subcontractors. That is what we refer to as a pure bond loss. In addition to that, there is loss that is classified as loss that goes out to consultants fees, attorneys' fees, and other servicing expenses, to take care of those losses. Those figures are more prone to become inflated. Because the bond loss is pretty well controlled by the unpaid invoice, or is controlled by the big price to complete. There may be a tendency for these costs to increase on the soft side with respect to the servicing aspect. And I think that the approach has to be looked at from the standpoint of what are the facilities of the surety company that in-house assumes more of that function, and would under some kind of agreement would have the assurance that the surety would go outside in the event that they would have to engage outside counsel in the event of litigation.

Mr. DAUB. A thoughtful answer. Gentlemen, thank you. Mr. Chairman, thank you, very much.

Mr. MITCHELL. I thank you, too, gentlemen. And I thank all of the witnesses. I must say that I get a little discouraged sometimes when we have these hearings when it is just the two of us.

Mr. DAUB. Well, that is the loss of the other members, Mr. Chairman.

Mr. MITCHELL. And I know that the other members are in other subcommittee meetings and full meetings. But honestly, I think that we have gotten some excellent testimony and recommendations here this morning. And if we suddenly were to draft some legislation to incorporate some of the recommendations into the Surety Bond Guarantee Program, we would have a whole lot of problems.

Mr. DAUB. Maybe not this time.

Mr. MITCHELL. Because the members would not have been here to hear firsthand. The entire transcript will be written up, and they will have an opportunity to read it. But in my opinion, there is nothing like that face to face, eyeball to eyeball contact with a witness in terms of just some excellent recommendations, and setting forth some specific problem areas, such as you have indicated, counsel. Thank you, all of you. It has really been the kind of hearing that I think that the subcommittee can be very proud of.

Mr. DAUB. I found it most worthwhile, too, Mr. Chairman. We appreciate your input to us today. Thank you.

Mr. MITCHELL. Thank you.

[Whereupon, at 12:20 p.m., the subcommittee adjourned to reconvene subject to call of the Chair.]

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